

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

**THE STATE OF CALIFORNIA CAN IMPROVE
THE CONTROL OF ITS FINANCIAL OPERATIONS**

REPORT BY THE
OFFICE OF THE AUDITOR GENERAL
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

F-374

THE STATE OF CALIFORNIA
CAN IMPROVE THE CONTROL
OF ITS FINANCIAL OPERATIONS

MARCH 1984



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March 20, 1984

F-374

Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning weaknesses in the State of California's control of financial operations. We noted the weaknesses during our review and evaluation of the State's internal accounting controls, its internal audit activities, and its compliance with federal grant requirements.

We found that while the State has corrected many of the weaknesses that we reported last year, the State continues to lose millions of dollars each year because state agencies do not adequately pursue amounts owed to the State, do not adequately monitor payroll and other disbursements, and do not maintain sufficient equipment records. We also found widespread noncompliance with the federal regulations governing the federal grants that the state administers.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Tom R. Hayes".

for THOMAS W. HAYES
Auditor General

Attachment

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INTRODUCTION

We have examined the General Purpose Financial Statements of the State of California for the year ended June 30, 1983. As part of this examination, we studied and evaluated the State's system of internal controls as required by generally accepted auditing standards, by the standards for financial and compliance audits of the Comptroller General of the United States, and by the Office of Management and Budget's Circular A-102, Attachment P.

The purpose of our study of the system of internal controls was to determine the audit procedures and the extent of testing required to express an opinion on the General Purpose Financial Statements of the State. In conducting our audit, we visited 31 of the State's more than 250 agencies; in dollar volume, these 31 agencies process more than 81 percent of the General Fund transactions; 91 percent of the Expendable Trust Fund transactions; 73 percent of the Special Revenue Fund and 72 percent of the Internal Service Fund transactions; and 36 percent of the Capital Project Fund transactions in the State.

We also reviewed the internal audit units of 18 state agencies for compliance with professional standards. We conducted two kinds of reviews of internal audit units: in-depth reviews and limited-scope reviews. In the in-depth review, we examined compliance with each of the Standards for the Professional Practice of Internal Auditing, as published by the Institute of Internal Auditors, Inc. We selected two

internal audit units for this comprehensive review: the Department of General Services' Performance Appraisal Review Section and the Department of Finance's Financial and Performance Accountability Unit. We conducted limited-scope reviews of 16 other internal audit units in the agencies included in our audit of the State's General Purpose Financial Statements. We limited our review of these units to determining the scope of internal audit work performed and the degree to which the internal audit units were independent of the activities they audited.

All federal grants over \$30 million were reviewed for compliance with federal regulations. We also selected a random sample of smaller grants. In all, we reviewed 49 of the 302 federal grants administered by the State. In addition, one grant over \$30 million was audited by outside CPA's. In dollar volume, these grants represent 94 percent of the federal funds received in fiscal year 1982-83.

The function of internal controls is to provide reasonable assurance that the State's assets are safeguarded against loss, that transactions are executed in accordance with management's authorization, and that transactions are recorded properly. The authority for establishing the system of internal accounting controls rests with the Department of Finance and state agencies, while the responsibility for implementing and maintaining the system rests with the management of each of the State's agencies.

The Department of Finance exercises its authority through the State Administrative Manual, which prescribes procedures and rules that all agencies must follow unless they are specifically exempted. In addition, the Department of Finance audits the agencies' adherence to the prescribed procedures. Each state agency exercises its authority through its own procedures manual. Some degree of control is also exercised by the State Controller, the State Board of Control, the Department of General Services, and the State Personnel Board. The State's internal controls thus consist of a multitude of individual systems that operate within the framework of the State Administrative Manual, the State Board of Control Rules, and the procedures manuals of individual agencies.

In the following sections of this report, we discuss the weaknesses in financial operations (which include revenue, expenditure, and reporting activities), weaknesses in controls over electronic data processing activities, and weaknesses in internal audit activities. We also discuss weaknesses in compliance with federal regulations governing the administration of federal grants. In addition, we present our report on the study and evaluation of the State's system of internal controls, show the distribution of weaknesses in internal controls by state agency, show the distribution of noncompliance with federal regulations by program, and provide a detailed description of the weaknesses we found in each agency.

During fiscal year 1982-83, we also issued 44 other audit reports, many of which discussed improvements needed in internal controls. (The titles of these reports are listed in Appendix A.) These reports are available to the public upon request.

AUDIT RESULTS

I

WEAKNESSES IN FINANCIAL OPERATIONS

We noted weaknesses in the financial operations of 26 of the 31 state agencies that we reviewed. Financial operations include all revenue, expenditures, and reporting activities. Twelve agencies did not adequately control revenue activities. Some of these agencies had not developed adequate procedures to ensure the monies owed the State were collected promptly; other agencies did not have adequate procedures to ensure that cash receipts were deposited promptly. As a result, the State not only lost the use of its assets, it also lost interest revenue. Sixteen agencies did not adequately control expenditure activities. As a result, the State inappropriately paid employees and has authorized duplicate payments. Finally, 23 agencies did not comply with the reporting requirements established by the Department of Finance. Consequently, state agencies did not record transactions consistently and financial information was sometimes incorrect. In the following sections, we discuss these weaknesses in more detail and provide examples of inadequate control over financial operations. Tables showing the distribution of weaknesses in financial operations by state agency appear on pages 51 through 55.

Weaknesses in Revenue Activities

Twelve of the state agencies that we reviewed did not adequately control revenue activities. Revenue activities include the receipt of tax collections and federal grants, billings for delinquent taxes and for goods and services rendered, and subsequent follow-up and collection of those billings. Several agencies did not maintain adequate procedures for collecting and recording accounts receivable or for classifying and depositing cash that was collected. As a result, many receivables were either collected long after they were due or not collected at all, the agencies' financial reports at June 30, 1983, were improperly stated, money owed the State was not available for the State's use, and the State lost approximately \$170,000 in interest income that would have been earned had the money been collected and deposited promptly. Moreover, some agencies did not adequately separate the duties of collecting revenues from those of accounting for revenues. Without adequate separation of duties, state employees would be able to use cash receipts for unauthorized purposes.

Billing and Collecting Receivables

Five agencies had inadequate procedures for billing or collecting money owed to the State. Sections 8776.3 and 8776.5 of the State Administrative Manual require that agencies bill as soon as possible after recognizing a claim due the State and develop procedures for collecting accounts receivable. Furthermore, Section 8755 requires

state agencies to bill promptly for services provided to maximize the State's interest earnings.

We noted that three agencies did not promptly request federal reimbursement for services provided. For example, the Department of Parks and Recreation did not prepare the reports necessary to request federal reimbursement until 17 months after a project was completed. We estimate that the State lost approximately \$48,000 in interest earnings because of the department's delay. Similarly, we estimate that the State lost at least \$121,500 in interest because the Department of Social Services did not execute federally reimbursable contracts in a timely manner. Finally, the Department of Transportation had not billed the federal government for \$453,000 in reimbursable utility relocation costs even though these costs had been eligible for reimbursement from two to six years.

We found that several agencies had inadequate procedures to ensure the timely collection of accounts receivable. For example, the Department of Transportation did not establish adequate collection procedures for the sale of excess lands. As a result, \$1.6 million in receivables were more than 9 months overdue at June 3, 1983. At June 30, 1983, the Department of Parks and Recreation's salary advances outstanding over six months totaled approximately \$18,000. These advances constituted more than half of the department's total salary advances at June 30, 1983. The long-outstanding advances result from a lack of effort to collect amounts due from employees.

Identifying and Depositing Collections

Seven of the state agencies that we reviewed had inadequate procedures for identifying and/or depositing collections. As a result, monies collected for the State were not immediately available for state use, and the State lost interest income.

According to Section 7630 of the State Administrative Manual, the uncleared collection account is used to record cash collections that are being analyzed to determine whether they are to be refunded to payers or remitted to a fund in the State Treasury. Failing to identify these collections can result in the failure to refund amounts due to payers. Moreover, until collections are properly identified, there may be an understatement of funds available for appropriation because remittances are not made to the correct fund in the State Treasury.

Two state agencies we reviewed had not identified a significant portion of their collections at June 30, 1983. For instance, the Department of Motor Vehicles' uncleared collections account balance totaled approximately \$112 million as of June 30, 1983. In addition, the department was unable to provide a detailed listing of the uncleared collections that matched the account balance total. In another example, the State Department of Education recorded amounts in the uncleared collection account that we readily identified as grant monies and reimbursements received for other funds. As a result, the June 30, 1983, uncleared collection account balance of \$1.4 million included over \$1 million belonging to other funds.

Six agencies had inadequate procedures for depositing collections. Section 8030.1 of the State Administrative Manual requires departments to deposit cash receipts exceeding \$500 in cash or \$5,000 in checks on the day of receipt, if possible, and no later than the next working day. Failure to deposit cash receipts promptly may result in the State's losing interest income. For example, because the State Department of Education did not promptly deposit cash receipts, the State lost at least \$15,000 in interest.

Recognition of Revenues

Four agencies did not accurately report to the State Controller revenues that had been earned as of June 30, 1983. Section 8290 of the State Administrative Manual requires that amounts that are earned but not received by the end of the fiscal year be accrued as revenue of the current year if they are estimated to be collectible within one year. The State Controller uses information reported by agencies to prepare the State's annual financial statements. If the agencies submit erroneous or incomplete information and the errors are not detected, the State's annual reports will be incorrect.

The Department of Transportation was one of the agencies exhibiting this weakness. The department recorded \$4.2 million in revenue for sales of excess land even though the sales had not entered or completed escrow. Until the sales complete escrow proceedings, there is no debtor liability. Under generally accepted accounting principles,

income is not accrued unless the debtor's liability has been clearly established. On the other hand, the department failed to accrue revenue it had earned and expected to receive within one year from rental properties. Section 10591 of the State Administrative Manual states that revenue should be accrued when it has been earned as of June 30 and is determined to be collectible within one year.

Inadequate Separation of Duties Involving Revenues

Two agencies we reviewed did not adequately separate incompatible duties involving revenues. Section 8080 of the State Administrative Manual lists duties that should be segregated. For example, employees who receive and deposit cash should not also post subsidiary ledgers used to record transactions affecting cash. However, at the Department of Mental Health we noted that an employee who received and deposited cash also maintained the cash disbursements register. Likewise, employees at the Department of Forestry who received and deposited cash also maintained the cash receipts register. Unless these incompatible duties are adequately separated, employees can use cash receipts for unauthorized purposes and conceal the irregularities.

Weaknesses in Expenditure Activities

Sixteen of the state agencies that we reviewed maintained inadequate control over expenditure activities. Expenditure activities include payroll, purchase of and payment for goods and contracted

services, and payment of benefits or grants to individuals or other governmental entities. While agencies generally initiate and authorize requests for payment, the State Controller prepares and issues the warrants for payment. However, when it is more efficient and beneficial for the State to expedite payments, agencies are authorized to prepare and issue payments from their own revolving fund.

We found that several agencies did not adequately control payroll expenditures and other disbursements. In addition, several agencies did not adequately control the use of the revolving fund, and agencies did not accurately accrue expenditures at end of the year. Finally, several agencies failed to separate incompatible duties pertaining to payroll, personnel, and other operating transactions. These weaknesses affect budgetary controls and expose the State to loss of funds from improper or fictitious disbursements.

Inadequate Control over Payroll Expenditures

We found that several agencies did not adequately control payroll expenditures. Specifically, the agencies did not maintain adequate documentation supporting payroll expenditures or adequately review final payments to separating employees. As a result, employees were not paid appropriately and employees were allowed to leave state service before returning state property and repaying outstanding advances.

Five of the agencies we reviewed had inadequate procedures to ensure that lump-sum leave payments made to separating employees had been computed correctly. As a result, we found errors in the final payments made to 29 employees. These errors included approximately \$2,000 in overpayments and \$9,000 in underpayments. At the State Department of Education, for example, an employee leaving the department was not paid approximately \$1,850 of accumulated vacation pay due to a reporting error. The department's system of review over these transactions failed to detect the error.

In addition, four agencies did not maintain adequate leave and attendance records. The Department of Health Services' personnel unit, for example, processed regular payroll before receiving attendance reports from the attendance clerks for the program units. During our examination, we found attendance reports that had been submitted as late as six months after the payrolls had been processed; in some cases, the personnel unit had never received the reports. As a result, the department may be paying employees for time they did not work. Section 10.231 of the State Payroll Procedures Manual requires that personnel units certify payroll reports based on actual time worked.

Finally, we found that the Board of Equalization and the Department of Social Services allowed employees to leave state employment without having a completed and authorized checkout document on file. The checkout document shows that an employee has returned all state property and repaid outstanding travel and salary advances. Section 8580.4 of the

State Administrative Manual states that salary warrants should not be distributed to terminating employees until outstanding advances have been paid. Because these agencies do not adhere to the established checkout procedures, they have no assurance that the employees returned all property and money due the State. Further, after an employee has left state service, it is more difficult to retrieve the State's assets.

Inadequate Control over Disbursements

We found that four agencies did not have adequate controls over disbursements. Failure to adequately control disbursements can result in erroneous, unauthorized, or duplicate payments. For example, at the Department of Forestry, regional offices submitted to department headquarters subpurchase orders and bank draft vouchers instead of vendor invoices. The department then forwarded these documents to the State Controller for payment. Duplicate payments occurred when the vendor invoice was also presented for payment.

In addition, the Franchise Tax Board did not have formal procedures to verify the accuracy of computer-generated claim schedules prior to authorizing payment. Due to this lack of review, the board issued duplicate refunds totaling \$4 million in November 1982.

Inadequate Control over Revolving Fund

Five agencies did not adequately control the use of their revolving fund. We found weaknesses in the preparation, recording, and reconciling of revolving fund transactions. For example, the Department of Parks and Recreation did not maintain a revolving fund receivables ledger. Consequently, we were unable to obtain adequate documentation to support revolving fund balances. Section 8190 of the State Administrative Manual requires that state agencies use a cash book and a receivables ledger to account for all revolving fund transactions.

In another instance, the Department of Forestry had not prepared a monthly reconciliation of its revolving fund since November 1982. Section 7922 of the State Administrative Manual requires monthly reconciliation of revolving fund advances. Failure to promptly reconcile the revolving fund may prevent prompt detection of errors or irregularities.

Inadequate Recognition of Expenditures

We found six agencies that did not accurately report expenditures at June 30, 1983. Because the State Controller uses the information submitted by agencies to prepare the State's annual financial statements, failure to submit complete and accurate information could result in the State's financial statements being misstated.

For example, the Department of Water Resources improperly recorded the encumbrances outstanding at the end of the year as liabilities and expenditures. Consequently, liabilities and expenditures were overstated by approximately \$33 million each. In another instance, the Department of Transportation did not accurately identify which of its unliquidated encumbrances constituted obligations at the end of the year. As a result, the department understated its obligations by \$12.6 million. While these errors did not affect the agencies' legal basis statements, we had to adjust the statements in order to report expenditures in conformance with generally accepted accounting principles.

We also found that the State Department of Education misstated expenditure accruals. As the net result of this error, the Federal Trust Fund was overstated by \$7.3 million and the General Fund was understated by \$2.2 million. Furthermore, we found that the department failed to disclose in its financial statements several significant contingent liabilities and liabilities payable from future appropriations.

Inadequate Separation of Duties Involving Disbursements

At seven of the state agencies, we noted inadequate separation of duties involving authorizing, processing, and distributing payroll warrants and revolving fund checks. Four of these seven agencies had not adequately separated duties pertaining to payroll and personnel functions. For instance, at the Department of General Services, employees who process attendance and other payroll documents also handle

undistributed salary warrants. Section 8580.1 of the State Administrative Manual specifies that persons who receive salary warrants, distribute salary warrants to employees, or handle warrants for any other purpose should not be authorized to process or sign personnel documents. Unless these duties are separated, an employee could authorize a fictitious payment for personal use.

We also noted that some agencies did not adequately separate other incompatible duties relating to expenditures. At Humboldt State University, for example, one employee was responsible for authorizing payment and preparing and countersigning the checks for the refund of fees and scholarship monies. The same employee also maintained the depositors ledger, which represents the cash receipts and disbursements register for scholarship monies. Section 8080 of the State Administrative Manual states that employees who prepare checks and maintain cash receipts and disbursements registers should not also authorize disbursements or sign checks. Failure to adequately separate disbursement duties could result in payments to fictitious employees or unauthorized payments for goods and services that were not received.

Weaknesses in Reporting Activities

We found weaknesses in the reporting activities of 23 of the agencies that we audited. Reporting activities include recording transactions in the accounting records and preparing various reconciliations and year-end financial statements. We found that several

agencies did not record transactions in compliance with the requirements established by the Department of Finance. Of particular concern is the agencies' inadequate accountability for fixed assets. In addition, several agencies did not have adequate reconciliation procedures and did not adequately or promptly prepare financial reports. Finally, we found weaknesses that complicate the conversion from the State's legal basis of accounting to the accounting methods specified by generally accepted accounting principles.

Improper Accounting Practices

Nine of the agencies we reviewed did not record transactions in the manner specified by the Department of Finance in the State Administrative Manual. As a result of these deficiencies, account balances were misstated and transactions were not recorded consistently from agency to agency. The Franchise Tax Board, for example, did not record transactions in the Due to Other Funds account in accordance with Section 10440 of the State Administrative Manual. Although the board properly recorded the liability in the Due to Other Funds account when monies were collected for another fund, the board did not reduce the liability when the monies were subsequently transferred to the other fund. As a result, the balance of the Due to Other Funds account was misstated during the year.

The Department of Consumer Affairs provides another example. Instead of depreciating the fixed assets of a working capital fund, as instructed by Section 8651.5 of the State Administrative Manual, the department charged to expenditures the entire cost of the asset at the time of purchase. As a result, expenditures were overstated in the year the asset was purchased and understated thereafter for the useful life of the asset.

Inadequate Accountability for Fixed Assets

State agencies do not maintain sufficient records to determine or to estimate the original cost of acquiring general fixed assets. Furthermore, state agencies do not consistently inventory fixed assets and do not record all fixed assets in the property records.

Because the agencies have not maintained adequate property records, the State is exposed to an increased risk of loss of assets. Further, the State Controller was unable to present the General Fixed Assets Account Group in the General Purpose Financial Statements. As a result, we had to qualify our opinion on the fairness of the presentation of the General Purpose Financial Statements.

A major problem is that the State Administrative Manual does not require agencies to retain records that support the historical cost or value of acquired or donated property. Invoices supporting the cost of property are currently included in claim schedules maintained by

agencies and the State Controller. These claim schedules are normally shipped to the State Archives within two years. The warehouse operated by the State Archives normally keeps the records for five years from the date of origination. However, most of the State's fixed assets are more than five years old. Consequently, because the records have been destroyed, a large portion of the fixed asset values cannot be substantiated.

Inadequate Reconciliations

Twelve of the agencies we reviewed did not prepare adequate reconciliations of accounts. Reconciliations are an important element of internal control because they provide a high level of confidence that transactions have been adequately processed and that the financial records are complete. Failure to reconcile agency accounts can result in the misstatement of account balances and may prevent the prompt detection of unauthorized transactions or errors.

Five of the agencies did not prepare adequate bank reconciliations. For example, the Department of Health Services failed to include in its bank reconciliation several deposits in transit totaling \$76,000. As a result, the department's June 30, 1983, cash balance was understated by that amount. Similarly, the State Department of Education was unable to reconcile the cash balance in its accounting records to the cash balance in its bank statement. At June 30, 1983, the department's cash balance in the accounting records was approximately \$50,000 higher than the balance in the bank statement.

Nine agencies did not adequately prepare other key reconciliations. For example, because of inadequate reconciliation procedures, the Board of Equalization failed to detect errors in the distribution of retail sales tax revenues to cities and counties. As a result, the board underpaid cities and counties by \$1.1 million and the error went undetected for a year. In another case, neither the Board of Governors of the California Community Colleges nor the Department of Water Resources reconciled property records to their accounting records. As a result, amounts reported in the agencies' financial statements were not adequately supported.

Inaccurate and Untimely Preparation of Financial Reports

As part of our examination, we reviewed the mathematical accuracy and reconciliation of the agencies' financial reports. We found that 14 agencies had incorrectly prepared or failed to prepare all required financial reports. In addition, several agencies did not submit their financial statements by the required due date.

The Department of Mental Health, for example, did not prepare three of the reports required by the State Administrative Manual, including the "Reconciliation of Agency Accounts with Transactions per the State Controller." This report is a critical internal control in the State's accounting system because it assures that transactions were recorded correctly by both the agency and the State Controller. In another instance, the State Department of Education did not identify a

\$955,000 reconciling item on its "Statement of Changes in Fund Balance Clearing." As a result, the department had no assurance that revenue and expenditure accounts reported in the department's financial statements were correct.

Additionally, nine of the agencies we reviewed did not submit required financial reports on time. Section 7950 of the State Administrative Manual requires that financial reports for Governmental Cost Funds be submitted by July 20 and that financial reports for Nongovernmental Cost Funds be submitted by August 20. The Department of Forestry, however, did not submit its financial reports to the State Controller until December 9, 1983, approximately four months after the due dates specified in the State Administrative Manual. Failure to submit final financial statements promptly delays the State Controller's compiling of complete financial statements.

We observed that a major reason for the untimely reporting was that several agencies converted from a manual bookkeeping system to the complex computerized California State Accounting and Reporting System (CALSTARS). Ten of the agencies we audited use the CALSTARS; nine of these agencies issued untimely financial statements.

Inadequate Procedures for Conversion to GAAP Basis

The State Controller prepares the Annual Report in conformity with the State's legal basis of accounting and prepares the General

Purpose Financial Statements in conformity with generally accepted accounting principles (GAAP) for governmental agencies. However, the Department of Finance has not provided sufficient instructions in the State Administrative Manual to make the conversion from the legal basis to the GAAP basis efficient and reliable. As a result, the financial information that agencies provide to the State Controller is frequently inadequate. In the following paragraphs, we discuss the main differences between the legal basis of accounting and the GAAP basis that have not been adequately communicated to the agencies.

Under the legal basis of accounting, monies earned by the State for some services provided to external entities are recorded as reimbursements. The State Controller subsequently combines reimbursements with expenditures and then reports only net expenditures in the Annual Report. In contrast, the GAAP basis of accounting for governmental entities requires that receipts from sources external to the state government be accounted for as revenues and that they not be used to reduce expenditures. The resulting statement more fully shows the activities of the governmental entity.

Another difference between the legal basis of accounting and the GAAP basis lies in the recording of disbursements. As a general rule, under the legal basis, disbursements from a fund are recorded as expenditures of that fund, even though the disbursements may represent transfers, advances, or loans. Under the GAAP basis, transfers are shown in a separate category on the operating statement to avoid accounting for

expenditures twice. Also, since advances and loans do not represent expenditures at the time the disbursements are made, they appear only on the balance sheet. They become expenditures only when goods and services are received or when a loan is forgiven. Accordingly, loan repayments do not represent revenues.

While inadequate communication to state agencies regarding these differences in accounting has hampered the conversion from the legal basis to the GAAP basis, inconsistency in state law adds a further complication. State law does not treat all expenditures consistently. Although most of the State's expenditures are converted to an accrual basis at year end in accordance with GAAP, the law requires that the Health Care Deposit Fund remain on a cash basis. If this provision were changed, the State's accounting system would become more consistent, and a significant adjustment needed to convert financial statements to the GAAP basis of accounting would be eliminated.

Insufficient Information
for GAAP Purposes

The financial information required under GAAP is more extensive than the information provided by the legal basis of accounting. As a result, the State needs to develop additional information for proprietary funds and nonexpendable trust funds, lease commitments, unused vacation and sick leave balances, and the market value of the State's investments in securities.

Generally accepted accounting principles require that governmental entities account for the operations of proprietary funds and nonexpendable trust funds in essentially the same manner as private business enterprises. Therefore, the State's financial statements should not only include a balance sheet and an operating statement but also a statement of changes in financial position for those funds. In addition, GAAP require that financial information on segments of an enterprise be included in the notes to the financial statements. The State Administrative Manual does not address these requirements.

Generally accepted accounting principles also require extensive information on lease commitments. These disclosures relate not only to lease-purchases but also to operating leases. Currently, the Department of General Services classifies most leases as operating leases because of the standard provision in governmental lease contracts that allows governmental units to terminate leases for lack of funding. However, some leases should be reclassified as capital leases, that is lease-purchases, for presentation in the General Purpose Financial Statements.

Furthermore, the recently issued Statement No. 4, "Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences," of the National Council on Governmental Accounting requires certain disclosures for compensated absences (e.g., paid vacation and sick leave). For instance, liabilities for compensated absences must be accumulated at the end of each accounting period and be

adjusted to current salary costs. Although the requirement does not have to be implemented until fiscal year 1983-84, the Department of Finance should address this problem early.

Finally, we found that the State Treasurer does not report the market value of the State's investments in securities at the end of the fiscal year. Such reporting is required under generally accepted accounting principles.

II

WEAKNESSES IN ELECTRONIC DATA PROCESSING ACTIVITIES

Seven of the state agencies we reviewed had various types of inadequate internal controls over electronic data processing (EDP) activities. EDP activities include recording and processing of daily business transactions as well as designing and maintaining the system. We found weaknesses in the following areas: separation of incompatible duties, systems documentation, access control, provision for backup, and input control. A table showing the weaknesses in electronic data processing activities by state agency appears on page 57 of this report.

Two state agencies we reviewed did not separate incompatible duties. At the Board of Governors of the California Community Colleges, one employee acted as a programmer, systems analyst, and computer operator. Failure to separate these duties could result in unauthorized modifications to programs or files. The board had not developed other control procedures to mitigate this weakness.

Two of the state agencies had inadequate systems documentation. For example, the Board of Governors of the California Community Colleges did not maintain adequate documentation of the programs used to calculate the apportionment of state funds to the community colleges. In addition, the board did not maintain documentation to show that program changes were authorized. Program documentation provides an effective control

over corrections and revisions to programs and helps ensure that only authorized changes are made.

Four state agencies had inadequate controls over access. Failure to limit access to documentation, files, programs, and hardware increases the potential for unauthorized modifications to files and programs, as well as misuse of the computer hardware. For example, the on-line stock inventory system at the Office of State Printing did not require persons to use a password to gain access to the inventory data file. In addition, employees logged-on in the morning but did not log-off after completing their transactions. As a result of these weaknesses, persons not authorized to have access to the stock inventory system would be able to change the value of inventory.

We also found that the State Board of Equalization does not have adequate EDP backup procedures. For example, the board has not arranged to use the EDP equipment of other data centers to ensure continued processing of sales tax returns if its own data processing equipment cannot function. As a result, the board would be unable to post taxpayers' accounts in a timely manner, and there could be delays in distributing retail sales tax revenues to local governments.

Finally, we found that the State Department of Education was circumventing input controls. For example, department employees routinely overrode controls provided by the CALSTARS. These overrides were performed without written authorization or subsequent review. The

department's actions minimized the effectiveness of the controls provided by the CALSTARS. Bypassing input controls can cause data to be lost, suppressed, added, duplicated, or otherwise improperly changed and can result in incorrect financial reports.

III

WEAKNESSES IN INTERNAL AUDIT ACTIVITIES

Fifteen of the 18 internal audit units we reviewed were not in compliance with the professional standards for internal auditing established by the Institute of Internal Auditors, Inc. Sections 1236 and 10529 of the Government Code require that state agencies with internal audit units comply with these standards. The standards embody the goals of internal auditing that pertain to independence, professional proficiency, scope of work to be performed, conduct in the performance of audit work, and management of internal auditing departments.

Internal audit units are a basic component of internal control. Internal audit units review and evaluate an agency's internal controls and appraise the efficiency of the agency's operations. Internal audit units provide management with recommendations to remedy internal control weaknesses and increase the overall efficiency of operations. In addition, the internal audit unit may perform work for external auditors, thus reducing the State's costs for audits.

Unless the internal audit units comply with professional standards, management has no assurance that the work of the internal auditors can be relied upon. In addition, external auditors are precluded from using the work of internal auditors when the internal auditors do not comply with professional standards.

In the following sections, we present examples of the deficiencies we noted.

Variances from the Independence Standard

Five of the 18 agencies we reviewed were not organizationally independent of all the activities they audit. Lack of organizational independence may have an adverse influence on the auditor's objectivity. For example, the internal audit unit of the Department of Rehabilitation reports to the deputy director of Administrative Services. The deputy director is also responsible for the accounting function. Since the accounting function is a major area that the internal auditors review, the deputy director may face a conflict of interest.

Variances from the Professional Proficiency Standards

The internal audit unit in the Department of Finance can improve its compliance with the professional proficiency standard. Specifically, the internal audit unit did not adequately document the supervision of staff. We found evidence that supervisors did not review audit workpapers until after the field work was completed. We also found that supervisory review notes to the audit staff were not always cleared or followed-up before the audit report was issued. As a result of these weaknesses, errors may go undetected, leading to erroneous audit reports.

Variances from the
Scope of Work Standard

Thirteen of the 18 internal audit units had variances from the scope of work standard. The scope of work standard requires that internal auditors examine and evaluate the agency's internal controls and the agency's performance in carrying out assigned responsibilities. Eight of these 13 audit units were not adequately evaluating their agencies' internal controls. These units had limited their work to reviewing fraud cases, selected segments of the department's operations, selected programs, or selected contractors. These limited reviews were not sufficient for drawing conclusions about the adequacy of the agencies' internal controls. However, during fiscal years 1981-82 and 1982-83, the Department of Finance did review, evaluate, and report on the internal controls at 7 of these 8 agencies.

In the five internal audit units that were reviewing internal controls, we found that the scope of the work performed was inadequate. For example, auditors at the Franchise Tax Board and the Board of Equalization usually limited their work to filling out questionnaires and writing narrative descriptions of internal controls; however, they did not always test and evaluate compliance with the internal controls. Furthermore, the scope of work performed by internal auditors of the Department of Motor Vehicles did not include tests of the revenue transaction cycle. The revenue transaction cycle is a significant function at the Department of Motor Vehicles; during fiscal year 1982-83, the department collected approximately \$1.9 billion in revenue.

Variances from the
Performance of Work Standard

The internal audit units in the Department of Finance and the Department of General Services do not always adequately document the planning of their audits. We determined that the unit in the Department of General Services did not always use audit programs to detail the audit procedures to be used and did not prepare audit plans to document the organization and staffing arrangements. Additionally, from a review of workpapers of the Department of Finance's internal audit unit, we determined that the audit staff did not always document their analysis of the relative importance of the items to be tested. Without adequate planning, audit staff may spend excessive time reviewing areas that do not have a significant effect on the agency's operations.

We also concluded that the internal audit units of the two departments do not always collect, analyze, interpret, or document sufficient information to support audit results. We found that auditors in the Department of Finance did not always identify the complete group of transactions from which they selected a sample of items for testing. Moreover, they did not always document the method used to select the sample or the attributes to be tested. We also noted that the workpapers of auditors in the Department of Finance and the Department of General Services did not always indicate sources of information, purposes for which information was obtained, descriptions of methods by which information was obtained, or the auditors' conclusions based on the work

performed. These deficiencies make it difficult to review workpapers and to determine whether there is sufficient evidence to support audit results.

Variances from the
Management of the Internal
Auditing Department Standard

The internal audit units in the Department of Finance and the Department of General Services are not fully in compliance with the management standard. The management standard states that proper management of the internal audit unit should include establishment of a plan to carry out the responsibilities of the internal auditing department, policies and procedures to guide the audit staff, a program for selecting and developing the human resources of the internal auditing department, procedures to coordinate internal and external audit efforts, and a quality assurance program to evaluate the operations of the internal audit unit.

At the Department of Finance, we found inadequate documentation of supervisory review. We noted that supervisors did not promptly review workpapers. Additionally, auditors in the Department of Finance do not always document coordinating their work with other auditors. Considering the audit work performed by other auditors is a good planning tool and can prevent duplication of work. Specific weaknesses we found at the Department of General Services include the following: lack of documentation of supervisory or managerial reviews of audit progress,

workpapers, or audit reports; lack of periodic appraisals of employee performance; and lack of a standardized internal self-assessment program. Without these elements, management of the internal audit unit cannot ensure that the work performed is of the required quality or that all issues in an audit have been resolved.

Additionally, we noted that the Department of General Services did not adequately maintain its continuing education program. We learned that supervisors have not received supervisory training in the last two years (calendar years 1982 and 1983). The department's administrative manual section 8800 requires that supervisors receive 40 hours of supervisory training every two years. The department developed the training program to ensure the quality of its staff. However, the department cannot be assured that its staff is maintaining skills and keeping up-to-date with new developments if it does not adequately maintain its training programs.

IV

WEAKNESSES IN COMPLIANCE WITH FEDERAL REGULATIONS

The federal government requires the State to comply with specific criteria on each of the grants that the federal government gives to the State. Typically, federal requirements address recipient eligibility, reimbursable costs, program monitoring, and reporting. We noted instances of noncompliance with federal regulations in 35 of the 49 programs we reviewed. The 49 programs are administered by 19 state agencies.

State agencies did not prepare accurate, timely federal reports for 29 of the programs we reviewed. In addition, the State did not fully meet the federal monitoring or auditing requirements of 17 of the programs we reviewed. Furthermore, the State did not maintain adequate support for expenditures being claimed for federal reimbursement in 23 of the programs we reviewed. Finally, we noted several instances in which the State did not draw and disburse federal funds in a timely manner. In our opinion, none of the conditions we noted was significant enough to place the State in jeopardy of losing continued funding; however, the federal government could require the State to return all funds that the State spent while not in compliance with federal grant requirements. In the following sections we discuss the four kinds of noncompliance we noted and provide specific examples of each kind. In our detailed description of weaknesses by state agency, we describe additional

instances of noncompliance with federal regulations; those instances of noncompliance were unique to particular programs. A table showing the distribution of weaknesses in compliance with federal regulations by program appears on pages 61 and 62 of this report.

Inaccurate and Untimely Federal Reports

Most federal programs require the State to submit financial reports periodically. We reviewed federal financial reports for mathematical accuracy, reconciliation to the accounting records, and timeliness of submission. We found that the State had incorrectly prepared or failed to prepare required federal reports for 29 of the 49 programs we reviewed. In addition, in some instances the State did not submit the reports by the required due date.

For example, the State Department of Education prepared the Financial Status Report for the Vocational Education grants using estimates that did not reconcile to the accounting records. Similarly, the "Federal Cash Transaction Report" prepared by the Department of Aging for supportive services and senior centers did not reconcile to the accounting records. The department's cash book at June 30, 1983, showed \$89,640 less than the "Federal Cash Transactions Report" for the same period.

Moreover, we found that some state agencies did not submit required federal reports on time. The State Department of Education, for example, which administers 13 of the programs we reviewed, was late in submitting 46 of the 52 Financial Status Reports that were due during fiscal year 1982-83. These reports were submitted up to 13 months after the due date.

Inadequate Support for Expenditures

To claim federal reimbursement for program costs, the State must be able to prove that costs were incurred and appropriately charged to the federal program. In 23 of the programs we reviewed, the State did not maintain adequate support for program costs.

For example, the Department of Justice overcharged the Medicaid Fraud Control Units grant by \$16,236 because the department billed indirect costs in excess of the amount approved in its Indirect Cost Plan. In another instance, the Department of Social Services did not maintain appropriate time distribution records to demonstrate that employee time was charged equitably to the various federal programs.

Inadequate Program
Monitoring and Auditing

For many of the programs we reviewed, federal regulations required the State to monitor program activities and to perform or enforce audit requirements. We found that the State did not adequately perform its monitoring and auditing responsibilities in 17 of the programs we reviewed.

For example, federal regulations require the Department of Health Services to monitor the Medical Assistance program by selecting, testing, and analyzing a sample of claims paid. However, the department failed to include a number of service codes in claims from which it selected the sample. Failure to include these codes jeopardizes the conclusions related to federal expenditures.

Federal regulations for the Migrant Education program require the State to monitor local educational agencies to ensure that these agencies are in compliance with federal regulations. We found, however, that personnel at the monitoring agency, the State Department of Education, did not conduct on-site visits to review eligibility documents or to verify that the local agencies used program funds appropriately. We also noted that the department does not adequately monitor audit exceptions to ensure that reported problems have been corrected. We reviewed 74 federal audit exceptions relating to various programs administered by the State Department of Education and found that the department had not adequately resolved 38 of these exceptions. As a

result, the department has no assurance that identified problems have been corrected or that federal monies are spent in compliance with federal regulations.

Untimely Draw and
Disbursement of Federal Funds

Federal regulations require the State to have adequate procedures to minimize the time between the transfer of funds from the U.S. Treasury and the disbursement of those funds by the State. There are similar federal requirements for advances of federal funds made by the State to grant recipients.

Six of the state agencies we reviewed did not draw or disburse federal funds in a timely manner. We found that while some state agencies requested federal funds in advance of actual need, other agencies did not request federal funds as soon as they were entitled to them. Delay in requesting federal funds resulted in a loss of interest revenue for the State. Finally, one agency did not have adequate procedures to ensure that advances to recipients were not disbursed in advance of actual need.

We found that at times, the Department of Social Services requested federal funds three months before it needed these funds. In one transaction, approximately \$3,514,248 was on hand three months before disbursement. The Department of Health Services also followed this practice. During the quarter ended June 30, 1983, the department's cash

balance of federal funds for the Special Supplemental Food Program for Women, Infants, and Children exceeded that authorized by the federal government. During the quarter, the department had a combined average daily cash balance of approximately \$4 million. This balance was sufficient to pay administrative and program expenditures for 10.8 working days. According to federal guidelines, the State should hold only enough federal cash to meet the department's needs for 3 working days.

CONCLUSION AND RECOMMENDATIONS

During our review of 31 state agencies, we noted widespread weaknesses in internal controls. For the most part, these weaknesses resulted because state agencies did not follow the procedures prescribed in the State Administrative Manual. However, we also noted that in some instances the State Administrative Manual did not provide adequate guidance.

Recommendations

The Department of Finance should monitor state agencies to ensure that agencies correct the weaknesses that we have identified.

The Department of Finance should revise the State Administrative Manual to ensure that state agencies provide sufficient financial information to facilitate the State Controller's preparation of the State's financial statements according to generally accepted accounting principles (GAAP).

**REPORT ON THE STUDY
AND EVALUATION OF
INTERNAL CONTROL**



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Members of the Joint Legislative Audit Committee
State of California

We have examined the General Purpose Financial Statements of the State of California as of and for the year ended June 30, 1983, and have issued our report thereon dated December 22, 1983. We did not examine the financial statements of the Pension Trust Funds, which reflect total assets constituting 73 percent of the Fiduciary Funds. We also did not examine the financial statements of certain Enterprise Funds, which reflect total assets and revenues constituting 53 percent and 68 percent, respectively, of the Enterprise Funds. In addition, we did not examine the University of California Funds.

As part of our examination, we studied and evaluated the State's system of internal controls to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards and by the standards for financial and compliance audits of the Comptroller General of the United States. For the purpose of this report, we have classified the significant internal controls of the State of California into three categories: financial operations, electronic data processing activities, and internal audit activities. Our study and evaluation included these three control categories. In addition, we reviewed the State's compliance with federal regulations.

Our examination did not include a study and evaluation of the system of internal controls for the Pension Trust Funds, certain Enterprise Funds, and the University of California Funds since these funds were examined by other auditors who furnished their reports to us.

The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the State's General Purpose Financial Statements. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal controls taken as a whole or on any of the categories of controls identified above.

The Department of Finance and the management of the agencies of the State of California are responsible for establishing and maintaining a system of internal accounting controls. In fulfilling this responsibility, they are required to make estimates and judgments to assess the expected benefits and related costs of control procedures. In addition, the Department of Finance issues reports on its reviews of internal controls at state agencies.

The objectives of a system of internal controls are to provide management with reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with the authorization of the Department of Finance and other agencies, and that transactions are recorded properly. Proper recording of transactions permits the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Also, projecting any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation, made for the limited purposes described in the fourth paragraph, would not necessarily disclose all material weaknesses in the State's system of internal controls. Accordingly, we do not express an opinion on the system of internal accounting controls of the State of California taken as a whole or on any of the categories of controls identified in the second paragraph. However, our study and evaluation disclosed one condition that we believe could result in errors or irregularities that may not be promptly detected. These errors or irregularities involve amounts that could have a material effect on the General Purpose Financial Statements of the State of California. This condition is the weakness in accounting for general fixed assets.

Weakness in Accounting for General Fixed Assets

The State does not maintain sufficient records to determine or to estimate the historical cost of general fixed assets. Furthermore, the State does not consistently inventory fixed assets and does not record all fixed assets in the property records. This weakness in accountability results in an increased risk of loss of assets and an inability of the State Controller to present the General Fixed Assets Account Group in the General Purpose Financial Statements.

Recommendation

The Department of Finance should require all agencies to comply with property accounting procedures that would allow the State Controller to include the General Fixed Asset Account Group in the General Purpose Financial Statements. Complying with property accounting procedures would assist in safeguarding the assets of the State.

The foregoing condition was considered in determining the nature, timing, and extent of audit tests to be applied in our examination of the financial statements. Our reporting of this condition does not modify our December 22, 1983, report on the General Purpose Financial Statements.

While our study and evaluation did not disclose any other material weaknesses, it did disclose certain conditions requiring the attention of management. The remaining sections of this report will discuss these conditions.

First, we present tables showing the distribution of weaknesses by state agency and the distribution of noncompliance by federal program. In the last section, we provide a detailed description of the weaknesses we found in each state agency and our recommendations to correct those weaknesses.

This report is intended for the use of the State of California, the federal government, and other interested parties.

OFFICE OF THE AUDITOR GENERAL

A handwritten signature in black ink, appearing to read 'Karl W. Dolk', with a stylized, cursive script.

KARL W. DOLK, CPA
Assistant Auditor General

February 24, 1984

**DISTRIBUTION OF WEAKNESSES
IN FINANCIAL OPERATIONS
BY STATE AGENCY**

WEAKNESSES IN REVENUE ACTIVITIES

<u>Agency</u>	<u>Inadequate Separation of Duties</u>	<u>Billing and Collecting Receivables</u>	<u>Identifying and Depositing Collections</u>	<u>Recognition of Revenues</u>
Aging, Department of				
California Community Colleges, Board of Governors				
Consumer Affairs, Department of			X	
Corrections, Department of				
Developmental Services, Department of				
Economic Opportunity, Office of				
Education, State Department of			X	X
Employment Development Department				X
Equalization, Board of				
Forestry, Department of	X	X		
Franchise Tax Board			X	
General Services, Department of				
Health Services, Department of				
Housing and Community Development, Department of				
Humboldt State University				
Industrial Relations, Department of				
Justice, Department of		X		
Mental Health, Department of	X			
Motor Vehicles, Department of			X	
Parks and Recreation, Department of		X	X	
Social Services, Department of		X		
State Controller, Office of				
State Treasurer, Office of				
State Water Resources Control Board				
Transportation, Department of		X	X	X
Water Resources, Department of			X	X

WEAKNESSES IN EXPENDITURE ACTIVITIES

<u>Agency</u>	<u>Inadequate Separation of Duties</u>	<u>Inadequate Control Over Payroll</u>	<u>Inadequate Control Over Revolving Fund</u>	<u>Inadequate Control Over Disbursements</u>	<u>Inadequate Recognition of Expenditures</u>
Aging, Department of					
California Community Colleges, Board of Governors		X			
Consumer Affairs, Department of					
Corrections, Department of					
Developmental Services, Department of					
Economic Opportunity, Office of			X		
Education, State Department of		X			X
Employment Development Department					X
Equalization, Board of		X			
Forestry, Department of	X		X	X	
Franchise Tax Board				X	
General Services, Department of	X	X			X
Health Services, Department of		X	X	X	
Housing and Community Development, Department of					
Humboldt State University	X	X			
Industrial Relations, Department of	X				
Justice, Department of					
Mental Health, Department of	X				
Motor Vehicles, Department of					
Parks and Recreation, Department of	X		X		X
Social Services, Department of		X		X	
State Controller, Office of					
State Treasurer, Office of					
State Water Resources Control Board					
Transportation, Department of	X		X		X
Water Resources, Department of					X

WEAKNESSES IN REPORTING ACTIVITIES

<u>Agency</u>	<u>Inadequate Reconciliations</u>	<u>Improper Accounting Practices</u>	<u>Untimely/ Inaccurate Financial Statements</u>
Aging, Department of			X
California Community Colleges, Board of Governors	X		
Consumer Affairs, Department of		X	X
Corrections, Department of			X
Developmental Services, Department of			X
Economic Opportunity, Office of			
Education, State Department of	X	X	X
Employment Development Department	X		X
Equalization, Board of	X		
Forestry, Department of	X		X
Franchise Tax Board		X	
General Services, Department of		X	X
Health Services, Department of	X		X
Housing and Community Development, Department of			X
Humboldt State University		X	X
Industrial Relations, Department of			X
Justice, Department of			
Mental Health, Department of			X
Motor Vehicles, Department of			X
Parks and Recreation, Department of	X	X	X
Social Services, Department of	X		
State Controller, Office of	X	X	X
State Treasurer, Office of	X		
State Water Resources Control Board			X
Transportation, Department of	X	X	X
Water Resources, Department of	X	X	X

**DISTRIBUTION OF WEAKNESSES
IN ELECTRONIC DATA PROCESSING
ACTIVITIES BY STATE AGENCY**

<u>Agency</u>	<u>Inadequate Separation of Duties</u>	<u>Inadequate Access Controls</u>	<u>Inadequate System Documentation</u>	<u>Inadequate Backup Provisions</u>	<u>Inadequate Input Controls</u>
Aging, Department of					
California Community Colleges, Board of Governors	X		X		
Consumer Affairs, Department of					
Corrections, Department of					
Developmental Services, Department of					
Economic Opportunity, Office of					
Education, State Department of			X		X
Employment Development Department		X			
Equalization, Board of				X	
Forestry, Department of	X	X			
Franchise Tax Board					
General Services, Department of		X			
Health Services, Department of					
Housing and Community Development, Department of					
Humboldt State University					
Industrial Relations, Department of					
Justice, Department of					
Mental Health, Department of					
Motor Vehicles, Department of					
Parks and Recreation, Department of					
Social Services, Department of					
State Controller, Office of					
State Treasurer, Office of					
State Water Resources Control Board					
Transportation, Department of					
Water Resources, Department of		X			

**DISTRIBUTION OF VARIANCES
FROM INTERNAL AUDIT STANDARDS
BY STATE AGENCY**

	<u>Independence Standard</u>	<u>Professional Proficiency Standard</u>	<u>Scope of Work Standard</u>	<u>Performance of Work Standard</u>	<u>Management of Department Standard</u>
<u>Full Scope Reviews</u>					
Finance, Department of		X	X	X	X
General Services, Department of	X		X	X	X
<u>Limited Scope Reviews</u>					
Consumer Affairs, Department of	X				
+ Developmental Services, Department of	X		X		
+*Education, State Department of	X		X		
Employment Development Department					
*Equalization, Board of			X		
*Franchise Tax Board			X		
+*Health Services, Department of			X		
+*Industrial Relations, Department of			X		
+*Mental Health, Department of			X		
Motor Vehicles, Department of			X		
+*Parks and Recreation, Department of			X		
Rehabilitation, Department of	X				
+*Social Services, Department of			X		
+*State Controller, Office of			X		
Transportation, Department of					
Water Resources, Department of					

+The internal audit unit does not adequately review the agency's internal controls.

*The Department of Finance performed the review of internal control.

**DISTRIBUTION OF WEAKNESSES
IN COMPLIANCE WITH FEDERAL
REGULATIONS BY PROGRAM**

<u>Federal Catalog Number</u>	<u>Grantor Agency/Program Title</u>	<u>Administering State Agency</u>	<u>Inaccurate/ Untimely Reports</u>	<u>Inadequate Support for Expenditures</u>	<u>Inadequate Monitoring/ Auditing</u>	<u>Untimely Draw/ Disbursement of Federal Funds</u>	<u>Other</u>
<u>U.S. Department of Agriculture</u>							
10550	Food Distribution	State Department of Education	X	X	X		
10551	Food Stamps	Department of Social Services and Employment Development Department	X	X			X
10553	National School Breakfast Program	State Department of Education	X	X	X		
10555	National School Lunch Program	State Department of Education	X	X	X		
10557	Special Supplemental Food Program for Women, Infants and Children	Department of Health Services	X			X	X
10558	Child Care Food Program	State Department of Education	X	X	X		
<u>U.S. Department of Health and Human Services</u>							
13633	Special Programs for Aging - Title III-Parts A & B	Department of Aging	X		X		
13637	Special Programs for Aging - Title IV-A - Training	Department of Aging			X		
13646	Work Incentive Program	Employment Development Department and Department of Social Services	X	X			X
13667	Social Services Block Grant	Department of Social Services	X				X
13679	Child Support Enforcement	Department of Social Services	X				X
13714	Medical Assistance Program	Department of Health Services and Department of Social Services		X	X	X	
13775	State Medicaid Fraud Control Units	Department of Justice		X		X	
13802	Social Security-Disability Insurance	Department of Social Services	X				X
13808	Assistance Payments - Maintenance Assistance (AFDC)	Department of Social Services	X				X
13814	Refugee Assistance - State Administered Programs	Department of Social Services	X			X	X
13818	Low-Income Home Energy Assistance Block Grant	Office of Economic Opportunity	X			X	X
13856	Microbiology and Infectious Diseases Research	Department of Health Services	X				
13991	Preventive Health and Health Services Block Grant	Emergency Medical Services Authority and Department of Health Services			X		X
<u>U.S. Department of Interior</u>							
15916	Land and Water Conservation Fund/State Assistance Program	Department of Parks and Recreation		X		X	

<u>Federal Catalog Number</u>	<u>Grantor Agency/Program Title</u>	<u>Administering State Agency</u>	<u>Inaccurate/ Untimely Reports</u>	<u>Inadequate Support for Expenditures</u>	<u>Inadequate Monitoring/ Auditing</u>	<u>Untimely Draw/ Disbursement of Federal Funds</u>	<u>Other</u>
<u>U.S. Department of Transportation</u>							
20205	Highway Research, Planning, and Construction	Department of Transportation				X	
<u>U.S. Environmental Protection Agency</u>							
66001	Air Pollution Control Program Grants	Air Resources Board	X	X			
66419	Water Pollution Control Board, State and Interstate Program Grants	Water Resources Control Board	X	X			
66426	Water Pollution Control - State and Areawide Water Quality Management Planning	Water Resources Control Board	X	X			
66438	Construction Management Assistance Grants	Water Resources Control Board	X	X			
<u>U.S. Department of Education</u>							
84003	Bilingual Education	State Department of Education	X	X	X		
84010	Educationally Deprived Children - Local Educational Agencies	State Department of Education	X	X	X		
84011	Migrant Education - Basic State Formula Grant	State Department of Education	X	X	X		
84027	Handicapped Preschool and School Programs	State Department of Education	X	X	X		
84048	Vocational Education - Basic Grants to States	State Department of Education	X	X	X		
84050	Vocational Education - Program Improvement and Supportive Service	State Department of Education	X	X	X		
84074	Career Education Incentive Program	State Department of Education	X	X	X		
84080	Gifted and Talented Children's Education Program	State Department of Education	X	X	X		
84126	Rehabilitation Services - Basic Support	Department of Rehabilitation	X				
84151	Improving School Programs - State Block Grants	State Department of Education	X	X	X		

**DETAILED DESCRIPTION OF WEAKNESSES
BY STATE AGENCY**

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DEPARTMENT OF AGING

The Department of Aging administers 2 of the 49 federal grants we reviewed. They are the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 13.633 and 13.637.

Item 1. Failure To Perform Financial Audits of Area Agencies on Aging

Finding: The department's audit unit has not performed a financial and compliance audit of the federal block grants for training and for supportive services and senior centers. The department provided these monies to area agencies on aging for the 1982-83 fiscal year. The audit unit had performed financial audits of the area agencies on aging every two years, but because of budget reductions, the department eliminated the funding of the audit unit in September 1983. The federal government may decide to reduce or eliminate the grant funds unless the audits are performed.

Criteria: U.S. Office of Management and Budget Circular A-102, Attachment P, Paragraph 8, requires that area agencies on aging must have a financial and compliance audit conducted at least every other year.

Recommendation: The department should require the audit unit to conduct financial and compliance audits of the area agencies on aging to comply with federal audit requirements.

Item 2. Federal Financial Statements Are Not in Compliance with Federal Requirements

Finding: The cash book that the department used to prepare the "Federal Cash Transaction Report" (SF 272) shows \$89,640 less than the June 30, 1983, report sent to the federal government for supportive services and senior centers. Because of this deficiency, the department's federal financial reports may not be accurate or reliable.

Criteria: U.S. Office of Management and Budget Circular A-102, Attachment P, stipulates that federal financial reports contain accurate and reliable financial data.

Recommendation: The department should reconcile its accounting records with all required federal financial reports to assure the accuracy of those reports.

Item 3. **Financial Statements Submitted to the State Controller Were Late**

Finding: The department submitted its financial statements for Governmental Cost Funds to the State Controller's office in final form on November 17, 1983, almost four months after they were due. Failure to submit final financial statements when due delays the State Controller's compilation of the financial statements for the Governmental Cost Funds of the State of California. Management indicated that turnover of key accounting positions during the period caused the delay in preparing and submitting the financial statements to the State Controller.

Criteria: State Administrative Manual Section 7990 requires that financial statements for Governmental Cost Funds be submitted to the State Controller by July 20 each year.

Recommendation: The department should prepare and submit its financial statements to the State Controller by the date they are due.

AIR RESOURCES BOARD

The Air Resources Board administers one of the 49 federal grants we reviewed. It is the U.S. Environmental Protection Agency grant, Federal Catalog Number 66.001.

Item 1.

Late Federal Financial Reports

Finding:

The ARB did not submit required federal financial reports promptly. The ARB did not submit quarterly Reports of Federal Cash Transactions for the period from January 1, 1982, to June 30, 1982, until October 21, 1982, and it did not submit the report for the quarter ended June 30, 1983, until August 8, 1983. Further, the ARB did not submit annual Financial Status Reports required for the periods ended September 30, 1981, and 1982, until March 9, 1982, and February 14, 1983, respectively.

The ARB's failure to comply with reporting requirements may cause the U.S. Environmental Protection Agency (EPA) to revoke the ARB's letter of credit.

Criteria:

Chapter 5 of the EPA Letter of Credit Users Manual requires that Reports of Federal Cash Transactions be submitted within 15 working days after the end of each calendar quarter and that Financial Status Reports be submitted within 30 days after the end of the fiscal year.

Recommendation:

The ARB should file all required federal financial reports promptly.

Item 2.

Inadequate Accounting Records for Federal Expenditures

Finding:

We could not audit the expenditures that relate specifically to EPA grant, Federal Catalog No. 66.001, because the ARB does not maintain accounting records adequate to differentiate federal grant expenditures from state General Fund expenditures. The ARB does not identify which claim schedules, contracts, invoices, and other source documents are chargeable to federal expenditures. Failure to maintain adequate accounting records to support federal grant expenditures in accordance with requirements specified in the grant agreement may cause the EPA to revoke the ARB's letter of credit.

Criteria: Part III-b-6 of the grant award agreement requires that accounting for assistance funds (including receipts, state matching conditions, and actual expenditures) must be maintained in accordance with all EPA regulations and generally accepted accounting principles. Further, the award agreement requires that support vouchers and records of expenditures must be maintained to show that federal funds have been used for the purposes intended.

Recommendation: The accounting officer of the ARB should establish adequate accounting and support records to identify the expenditures chargeable under EPA grant, Federal Catalog No. 66.001.

**BOARD OF GOVERNORS OF THE
CALIFORNIA COMMUNITY COLLEGES**

Item 1. **Lack of Separation of Duties in EDP Section**

Finding: One person in the EDP section of the Fiscal Services Unit acts as a programmer, systems analyst, and computer operator. This lack of separation of duties creates a significant weakness in internal control of apportionment calculations and presents opportunities for misuse of state funds.

Criteria: State Administrative Manual Section 4846.5 states that to the degree feasible, key data entry, computer operations, system programming, application design, and application programming be performed by separate individuals.

Recommendation: The board's relatively small staff size makes the adherence to this requirement impractical. Therefore, management should be aware of these weaknesses and develop procedures to closely monitor the EDP functions.

Item 2. **Inadequate Documentation of EDP Apportionment System**

Finding: The board has not adequately documented the EDP system that calculates the apportionment of state funds to the community colleges. Insufficient documentation exists for planning and testing the EDP programs and systems, for programming changes resulting from statutory requirements, and for the creation and maintenance of such systems and programs. Without adequate documentation, no basis exists to determine that the system is working as intended.

Criteria: Effective internal control over EDP activities requires that evidence exists of controls over system design, development, testing, and changes of the EDP system.

Recommendation: The board should determine and establish requirements for appropriate EDP documentation of all apportionment processes and management should ensure compliance with the requirements.

Item 3.

Inadequate Control over Property

Finding: The board has not conducted a physical inventory of furniture, fixtures, and equipment in over two years. Further, the board has not reconciled its property records to its accounting records. As a result, losses from the February 1983 fire cannot be accurately determined.

Criteria: State Administrative Manual Section 8659 requires that a physical inventory be taken at least once every three years and that this inventory be reconciled with the property records. Also, any lost, stolen or destroyed property is to be reported as outlined in Section 8657 of the State Administrative Manual.

Recommendation: The board should take a physical inventory to determine estimated losses from the February 1983 fire. The results of this inventory should be reconciled to the property records. Losses from the fire should be reported as specified in Section 8657 of the State Administrative Manual. In the future, the board should perform periodic physical inventories as required by Section 8659 of the State Administrative Manual.

Item 4.

Incorrect Leave Payments for Employees Separating from State Service

Finding: During fiscal year 1982-83, the board did not accurately calculate two of the ten leave payments for employees separating from state service. One employee was overpaid and the other underpaid. The board does not have an adequate system of review over these transactions to detect errors.

Criteria: Good internal control requires that computations of leave payments be reviewed for accuracy by a supervisor.

Recommendation: The board should develop a system of supervisory review of leave payments computed for employees separating from state service.

Item 5.

Inadequate Documentation for Accounting for Employee Leave

Finding: The board's current system of accounting for employee leave is unauditible because no written leave requests are required. Presently, all requests for leave are verbal between the employee and the supervisor. Without adequate procedures to document supervisory preauthorization and employee certification of leave requests, there could be a misuse of employee leave.

Criteria: Good internal control procedures require formal authorization and documentation of leave taken as an assurance of supervisory review and employee certification of leave taken.

Recommendation: The board should develop procedures that require formal supervisory preauthorization of vacation, compensating time off, or personal holidays and post authorization of sick leave. Also, employees should certify leave requests.

DEPARTMENT OF CONSUMER AFFAIRS

Item 1. Property Records for Fixed Assets-Improvements Are Incomplete

Finding: Records supporting the recorded value and acquisition dates for property and equipment are not available for most items constituting the Fixed Assets-Improvements account balance. Because it lacks this information, the department cannot substantiate the Fixed Assets-Improvements account balance at June 30, 1983.

Criteria: State Administrative Manual Section 8651 states that agencies should maintain records of all nonexpendable property and equipment.

Recommendation: The department should establish records for older acquisitions, and it should continue to maintain adequate supporting records for all new acquisitions.

Item 2. No Depreciation Recorded for Fixed Assets

Finding: The department charges to expenditures the fixed assets of the Consumer Affairs Fund at the time of their acquisition instead of depreciating the fixed assets (i.e., expensing the costs over the useful life of the asset). Department personnel stated that the budgeting requirements of the Department of Finance do not allow the department to budget in a manner that would allow them to allocate the costs of the fixed assets over the useful lives of those assets.

Criteria: The Department of Finance has classified the Consumer Affairs Fund as a working capital and revolving fund. State Administrative Manual Section 8651.5 states that working capital and revolving funds should use depreciation accounting methods when precise cost accounting is required for determination of charges to other entities.

Recommendation: The department should implement the depreciation accounting method for its Consumer Affairs Fund, and it should retroactively adjust the fund balance. The department should also bring its problems to the attention of the Fiscal Systems and Consulting Unit of the Department of Finance.

Item 3.

Inadequate Internal Control over Checks Received

Finding:	The boards and bureaus within the Department of Consumer Affairs do not stamp a "For Deposit Only" endorsement on the checks they receive before they forward those checks to the department's cashiering unit. As a result, the risk of improper handling of the checks increases.
Criteria:	Proper internal controls and State Administrative Manual Section 8034.1 require that checks be promptly endorsed on the day they are received.
Recommendation:	The department should require its boards and bureaus to endorse checks on the day of receipt before sending them to the cashiering unit.

OFFICE OF ECONOMIC OPPORTUNITY

The Office of Economic Opportunity administers one of the 49 federal grants we reviewed. It is the U.S. Department of Health and Human Services grant, Federal Catalog Number 13.818.

Item 1. Inadequate Management of Cash Advances Held by Contractors

Finding: The OEO has not properly managed cash advances to its Energy Crisis Intervention Program contractors. The OEO has not minimized the time between the transfer of federal funds from the OEO and the disbursement of those funds by its contractors. Also, the OEO has not limited contract advances and payments to the contractor's immediate cash needs. Consequently, of the 10 contractors we reviewed, 6 have held approximately \$463,000 in excess cash for 3 months or more.

Criteria: U.S. Office of Management and Budget Circular A-102, Attachment G, requires that state financial management systems include procedures to minimize the time between the transfer of funds from the granting agency and the disbursement of those funds by the contractors.

Recommendation: The OEO should develop and implement procedures to limit the amount of federal funds held by contractors.

Item 2. Failure To Provide the Highest Level of Assistance to Households with the Highest Energy Costs

Finding: The OEO has not ensured that it provides, promptly and efficiently, the highest level of assistance under its Low Income Home Energy Assistance Program block grant to households with the lowest incomes and the highest energy costs.

Criteria: Public Law 97-35, Section 2605(b)(5), requires that the highest level of assistance must be provided, in a prompt and efficient manner, to households that have the lowest incomes and the highest energy costs.

Recommendation: The OEO should develop procedures to ensure that it complies with federal requirements in disbursing energy assistance funds.

Item 3. **Failure To Notify Households of Amounts of Assistance Provided on Their Behalf**

Finding: The OEO has not required its contractors under the Emergency Crisis Intervention and Weatherization Programs to inform those households receiving funds of amounts of assistance paid by contractors on their behalf.

Criteria: Public Law 97-35, Section 2605(b)(7)(A), requires that states choosing to pay home energy suppliers directly establish procedures to notify participating households of the amount of assistance paid on their behalf.

Recommendation: The OEO should develop procedures to notify participating households of the amount of assistance paid on their behalf.

Item 4. **Inadequate Documentation of Assistance Denial Process**

Finding: When the OEO notifies prospective applicants that their application has been denied, the OEO does not retain a copy of the denial letter in the files. Without this documentation, there is no assurance that all applicants who are denied assistance are given an opportunity to appeal the OEO's decision at a fair hearing.

Criteria: Public Law 97-35, Section 2605(b)(13), requires that all individuals who are denied assistance have the right to a fair administrative hearing.

Recommendation: The OEO should keep a file copy of all denial letters that it sends to applicants.

Item 5. **Inaccurate Annual Reports Submitted to the Federal Government**

Finding: The "Annual Report on the Number and Income Level of Households" prepared by the OEO's Home Energy Assistance Program was inaccurate. The OEO provided information concerning approximately 22,000 households that was based on estimated rather than actual data.

Criteria: The federal regulations governing the block grant require an annual report, based on actual data, on the number and income level of households served.

Recommendation: The OEO should submit reports based on actual information.

Item 6. **Failure To Confirm Travel Advances**

Finding: The OEO has not sent letters to employees holding travel expense advances at the end of the fiscal year, requesting that these employees confirm their liability.

Criteria: State Administrative Manual Section 8116 requires agencies to confirm outstanding travel expense advances or request the return of these advances at the end of each fiscal year.

Recommendation: The OEO should confirm outstanding travel expense advances at the end of each fiscal year and keep responses on file in the accounting office.

Auditor General's The Office of the Auditor General is currently
Note: reviewing other grants administered by the Office of Economic Opportunity.

DEPARTMENT OF EDUCATION

The Department of Education administers 13 of the 49 federal grants we reviewed. They are the U.S. Department of Education grants, Federal Catalog Numbers 84.010, 84.011, 84.027, 84.048, 84.050, 84.074, 84.151, 84.080, 84.003, and U.S. Department of Agriculture grants, Federal Catalog Numbers 10.558, 10.550, 10.555, and 10.553.

Item 1.

Ineffective Organization of Financial Units

Finding:

Although the Accounting Office is responsible for preparing the department's financial statements, it does not control or receive all of the necessary information.

In addition to the Accounting Office, other units within the department perform financial activities. For example, certain educational programs have automated payment systems controlled outside the Accounting Office. The department has not sufficiently reviewed its accounting and reporting procedures. As a result, duplication of effort exists between the CALSTARS, which is controlled by the Accounting Office, and the various automated systems within the department. Also, because the automated payment systems are controlled outside the Accounting Office, the Accounting Office cannot ensure that its CALSTARS accounting records are properly stated unless it consistently interacts with other units within the department. The Accounting Office's inability to interact effectively has contributed to some of the other weaknesses identified in this document, specifically Items 4 and 13.

Criteria:

Good internal control dictates that an agency's financial and management systems ensure that the agency maintains sufficient control over financial matters, does not duplicate effort, and supplies adequate information.

Recommendation:

The department should reevaluate its current organizational structure to determine whether it could be reorganized to provide for better control over financial matters. The department should prepare a needs assessment study to determine whether the CALSTARS could be modified to become the department's sole financial system. If it must retain other automated systems, the department should

more effectively coordinate the operation and monitoring of these systems with functions of the Accounting Office.

Item 2. **Inadequate Accountability over Support Appropriation**

Finding: Subsequent to issuing its financial statements, the department discovered that it had overspent its General Fund appropriation by \$1,127,000. While reviewing its records to eliminate this apparent overexpenditure, the department identified numerous other errors, including expenditures of approximately \$710,000 charged to the General Fund that could have been charged to federal funds, overstatements of expenditures, and understatements of reimbursements. The department subsequently notified the State Controller of the necessary corrections.

Criteria: Good internal control dictates that an agency should sufficiently review its financial statements before issuing them to ensure that reported expenditures are within available appropriations, that available federal funds are used before state funds are used, and that significant misstatements do not exist.

Recommendation: Before issuing its financial statements, the department should review its financial information to ensure that expenditures and reimbursements are accurately reported, that available federal funds are used before charging state funds, and that the statements are accurate.

Item 3. **Inadequate Preparation of Financial Statements**

Finding: The department reported an unidentified reconciling item of approximately \$955,000 on its "Statement of Changes in Fund Balance Clearing" for the General Fund. Because the department is not able to account for all changes to its Fund Balance Clearing throughout the year, revenue and expenditure accounts as reported on the department's financial statements may not be fairly stated.

Criteria: State Administrative Manual Section 7960 requires that agencies prepare a "Statement of Changes in Operating Clearing" (referred to as Fund Balance Clearing for CALSTARS agencies).

Recommendation: The department should identify the entries constituting the \$955,000.

In the future, the department should identify any unknown reconciling items on its "Statement of Changes in Fund Balance Clearing."

Item 4.

Misstatement of Expenditure Accruals

Finding: The department significantly misstated its expenditure accruals, thereby misstating both its June 30, 1983, expenditures and accounts payable balances for both the Federal Trust Fund and the General Fund. The department reported accounts payable of \$94 million for the Federal Trust Fund and \$13 million for the General Fund at June 30, 1983. The net result of the misstatements was that the Federal Trust Fund was overstated by \$7.3 million, and the General Fund was understated by \$2.2 million.

We found the following specific errors:

1. The department overstated its Federal Trust Fund accruals by approximately \$3.9 million because it accrued more than legally allowed for the Child Nutrition appropriation for fiscal year 1982-83.
2. The department overstated its Federal Trust Fund accruals by an additional \$3 million because department staff failed to remove encumbrances related to appropriations for which expenditure authority had lapsed at June 30, 1983, from the accounts payable balance.
3. The department overstated its General Fund accruals by approximately \$1.7 million because Child Development contracts were not disencumbered when final expenditure reports were received. (As discussed further in Item 13, the department's Accounting Office does not receive final expenditure reports for programs that have automated payment systems.)
4. The department overstated its General Fund and Federal Trust Fund accruals by approximately \$671,000 and \$427,000, respectively, because department staff made various errors.
5. The department understated its General Fund accruals by approximately \$4.6 million because department staff failed to record encumbrances

in CALSTARS for the Child Development Preschool program and inappropriately decreased encumbrances for the general Child Development program.

Criteria: State Administrative Manual Section 10584 states that all encumbrances as of June 30 will be reviewed to determine that they are valid obligations of the year just ended and that the amounts are as accurate as can be determined.

Recommendation: The department should review its year-end accruals to ensure that they are accurate and within the legal spending authority. The department should ensure that the Accounting Office receives all documents regarding financial matters including those for educational programs that have automated payment systems. The Accounting Office should make the necessary adjustments to its records to correct the errors mentioned above.

Item 5. **Failure To Reconcile Department's Cash Records with Bank Statement**

Finding: The department has been unable to reconcile the cash balance in its CALSTARS records to the cash balance in its bank statement. At June 30, 1983, the department's cash balance in the CALSTARS records was approximately \$50,000 higher than the balance in the bank statement. Failure to reconcile accounts can result in the misstatement of cash balances and may prevent the detection of irregularities such as unauthorized disbursements or the failure to deposit money.

Criteria: State Administrative Manual Section 7921 requires agencies to reconcile the cash balance in their records to the bank statement sent by the State Controller each month.

Recommendation: The department should reconcile its June 30, 1983, cash balance to the bank statement and perform this reconciliation monthly as required.

Item 6. **Failure To Reconcile the State Expenditure Revolving Fund**

Finding: At the time that the financial statements were issued, the department was unable to certify the accuracy of its State Expenditure Revolving Fund (SERF) financial statements because the SERF had not

been reconciled. The SERF was still not reconciled at the end of our fieldwork (November 1983). Because the department disburses its state operations expenditures through the SERF, errors in the SERF may indicate misstatements of accounts in other funds.

Criteria: Reconciliations represent an important element of internal control because they provide a high level of confidence that transactions have been adequately processed and that the financial records are complete. State Administrative Manual Section 7900 discusses the importance of making regular reconciliations.

Recommendation: The department should continue its efforts to reconcile the SERF. In the future, the department should reconcile the SERF monthly.

Item 7. **Inappropriate Account Balances in the State Expenditure Revolving Fund**

Finding: At June 30, 1983, the department reported balances for certain State Expenditure Revolving Fund (SERF) accounts that should have had zero balances at the end of the year. Specifically, the department failed to allocate \$403,000 in encumbrances charged to SERF. Because encumbrances are reclassified as expenditures and accounts payable through the year-end closing process, unallocated encumbrances result in understated expenditures and liabilities for the funds that the encumbrances should have been allocated to. The department also reported a debit balance of \$216,000 in its Payroll Clearing Account and could not explain what this balance represented. This balance may represent an understatement of expenditures.

Criteria: The CALSTARS Year-End Closing Instructions state that at the end of the year, encumbrances must be distributed from the SERF to the ultimate funding source so that expenditures and related liabilities will be recorded in the proper fund. The Payroll Clearing Account balance should also be zero at the end of the year.

Recommendation: The department should analyze both the June 30, 1983, SERF unallocated encumbrances and the June 30, 1983, Payroll Clearing Account to determine what correcting entries should be made. In the future, the department should review its year-end trial balance for the SERF to ensure that SERF transactions have been properly accounted for.

Item 8.

Improper Use of CALSTARS Override Functions

Finding: Throughout the fiscal year, department employees routinely bypassed CALSTARS on-line edits. As a result, an extensive volume of errors was left to be detected by later processing edits. Additionally, the Fiscal Systems Operations Unit routinely overrode the fund control errors that were detected by processing edits without written authorization or subsequent review. A fund control error occurs when the posting of an accounting transaction causes a violation of a controlled amount in the appropriate CALSTARS masterfiles. The department's actions minimized the effectiveness of controls provided by the CALSTARS.

Criteria: Because an override circumvents the controls provided by a system, good internal control dictates that overrides should be used only in a limited number of special circumstances, authorized by supervisors, and subsequently reviewed by responsible agency personnel.

Recommendation: The department's accounting personnel should follow the "Input Guidelines" memorandum dated October 13, 1983, issued by the Fiscal Systems Operations Unit. This memorandum advises employees not to bypass on-line edits, and effective fiscal year 1983-84, it requires employees to correct rather than override those conditions causing fund control errors that are detected by the system. At the time of our fieldwork, the Accounting Office had not implemented these procedures, and we noted no significant improvements in this situation.

Item 9.

Inadequate Control over Changes Made to CALSTARS Tables

Finding: The Fiscal Systems Operations Unit did not keep a "table maintenance log" (a record of changes made to the CALSTARS tables) throughout fiscal year 1982-83. The Fiscal Systems Operations Unit ensures the accuracy of the changes made to the CALSTARS tables by comparing the activity reports with the related input documents. However, without a table maintenance log, it is difficult to research changes made to the tables. Also, the lack of a formal process to reconcile the control log and the table maintenance output reports minimizes the assurance that changes to the tables are consistently and adequately controlled.

Criteria: The CALSTARS Procedures Manual states that a control log should be kept for all changes made to the CALSTARS tables. The manual also states that the various activity reports must be reconciled to the table maintenance log to ensure that each table was properly updated.

Recommendation: The department should keep a control log of the changes made to CALSTARS tables and reconcile that log to the activity reports in accordance with the CALSTARS Procedures Manual.

Item 10. **Failure To Reconcile CALSTARS Reports**

Finding: For funds other than the General Fund, the department does not regularly reconcile its general ledger to the document reports. As a result of errors (primarily in the document file), the Federal Trust Fund Due to Other Funds balance and the Encumbrance account balance in the June 30, 1983, document report exceeded the general ledger by approximately \$14 million and \$4 million, respectively.

Additionally, the department does not reconcile subsidiary reports for general ledger accounts. Certain June 30, 1983, Due to/Due from Other Fund account balances in the General Fund and the Federal Trust Fund subsidiary reports did not agree with the corresponding fund's subsidiary report.

Criteria: According to the CALSTARS Procedures Manual, the document and subsidiary files are internal files maintained to support the general ledger. Therefore, reports generated from such files should be reconciled with the appropriate general ledger accounts or related subsidiary files.

Recommendation: The State Department of Education and the Department of Finance should determine if programmatic controls could be incorporated into the CALSTARS to provide better assurance that reports agree with the appropriate general ledger accounts and that specific accounts contained in various files agree with each other. Until such controls are implemented, the department should reconcile the reports generated from the various CALSTARS files each month.

Item 11.

Inadequate Documentation of CALSTARS Daily System Reconciliation

- Finding: The Fiscal Systems Operations Unit did not adequately document its preparation of the CALSTARS Daily System Reconciliation throughout the 1982-83 fiscal year. Reconciling items between batch control logs (items submitted for processing) and output reports (items processed) were not always explained, and adding machine tapes supporting the amount listed as input for the reconciliation were not saved. Therefore, we could not verify if the reconciliation process was always performed properly. Additionally, the Fiscal Systems Operations Unit could not provide any reconciliations prepared for July and August of 1982.
- Criteria: The CALSTARS Procedures Manual requires the preparation of a daily system reconciliation to ensure that financial transactions have been adequately processed and controlled. The manual stipulates that the batch control log be reconciled to the CALSTARS output reports.
- Recommendation: At the time of our fieldwork, we recommended ways to improve the documentation of the CALSTARS Daily System Reconciliation. Subsequent to the department implementing our recommendations, the department's documentation of the reconciliations improved. The department should continue to ensure that the reconciliation process is properly performed and adequately documented.

Item 12.

Understatement of Federal Revenue

- Finding: The department understated its Federal Trust Fund revenue and its Due From Other Governments account balance by approximately \$1.8 million because the Accounting Office did not consider state operations expenditure accruals when computing the related revenue accruals. Accounting Office staff believed that it would require too much staff time to make the necessary entries. They believe that the CALSTARS should perform this function automatically. The Accounting Office did, however, include local assistance expenditure accruals in its computation of revenue accruals.
- Criteria: Expenditures recorded in the Federal Trust Fund are fully funded by the federal government. Therefore, accrued expenditures in that fund should be matched by accrued revenue.

Recommendation: When computing Federal Trust Fund revenue at the end of the year, the department should consider state operations as well as local assistance expenditure accruals in the computation. The department should work with the Department of Finance to determine if this entry could be done automatically through the CALSTARS closing process at the end of the year.

Item 13. **Inadequate Accountability over Prepayments to Other Governments**

Finding: The department significantly overstated the Federal Trust Fund and the General Fund Prepayments to Other Governments account balances at June 30, 1983, because the department did not liquidate advances made to local educational agencies during fiscal year 1981-82 when it received final expenditure reports.

Although we noted that this situation existed for many programs, the most significant occurrence was the Title I Low Income program in which the department made advances of \$265 million in fiscal year 1981-82 but only liquidated \$38,000 during fiscal year 1982-83. Department personnel said that the problem exists because the Accounting Office does not receive final expenditure reports for programs that use automated payment systems. Thus, the Accounting Office does not know when an advance should be removed from the records. This condition results in no overall effect on the financial statements because the prepayments are fully reserved. However, a prepayment account provides control over advances. The department's actions have lessened this control.

Criteria: The Prepayments to Other Governments account represents advances made to local educational agencies for local assistance programs. Each advance remains on the department's records until a local educational agency submits a final expenditure report. At that time, the department should liquidate the advance.

Recommendation: The department should ensure that the Accounting Office receives final expenditure reports for all programs so that it can make the necessary liquidation of prepayments at the proper time.

Item 14.

Untimely Bank Deposits

- Finding: Twenty of the thirty bank deposits of cash receipts we examined were not made promptly. The department held one check for \$114,505 in its safe for eight months before finally making the deposit. We estimate that the State lost at least \$15,000 in total interest for the twenty items that the department did not deposit promptly.
- Criteria: State Administrative Manual Section 8030.1 requires deposits to be made on the day of receipt if possible, and no later than the next working day.
- Recommendation: The department should deposit cash received as soon as possible after the time of receipt. The department should photocopy checks if it is necessary to research the nature of the receipt.

Item 15.

Untimely Review of Amounts Owed to Federal Government

- Finding: The General Fund Due to Federal Government account consists of audit exceptions and overpayments that have been recovered from local educational agencies and that are owed to the federal government. Because the department has not reviewed or cleared money from this account since March 1981, the account balance has steadily increased. At June 30, 1983, the account balance was approximately \$133,000.
- Criteria: Good internal control dictates that the department should promptly review amounts received and owed to the federal government to determine if these amounts can be applied to current grants as cash on hand or be remitted to the federal government if the grant has expired.
- Recommendation: The department should review amounts currently in the Due to Federal Government account and determine what should be done with these items. In the future, the department should apply or remit amounts owed to the federal government as soon as possible after the amounts are received.

Item 16.

Improper Use of Uncleared Collections Account

- Finding: The department recorded in the General Fund Uncleared Collections account some amounts that are readily identified as grant monies and reimbursements received for other funds. The Uncleared Collections account balance of approximately \$1.4 million at

June 30, 1983, included \$660,000 of Federal Trust Fund monies and \$396,000 of reimbursements collected in advance for the Vocational Education program. The department staff did not attempt to record these monies in the appropriate funds, resulting in overstatement of General Fund cash and an understatement of cash and revenues in other funds.

Criteria: State Administrative Manual Section 7630 defines uncleared collections as collections that must be reviewed to determine their appropriate disposition. Collections readily identifiable should not be placed in the Uncleared Collections account.

Recommendation: The department should review uncleared collections and clear funds promptly.

Item 17. **Inadequate Documentation of Education Data Management Systems Controls**

Finding: Although the Education Data Management Systems Unit has recently made significant progress in documenting its systems, there is still insufficient documentation of controls over system design development, testing, and changes conducted in the past. Additionally, at the time of our review, certain significant apportionment systems had yet to be adequately documented.

Criteria: Good internal control over electronic data processing activities requires that there be evidence of controls over system design, development, testing, and changes.

Recommendation: The department should ensure that all systems documentation complies with the standards that the department recently implemented.

Item 18. **Failure To Set Up an Appropriate Provision for Deferred Receivables**

Finding: The department's accruals may be misstated because the Accounting Office did not analyze amounts owed to the department and, thus, did not set up an appropriate provision for deferred receivables. The department's June 30, 1983, Provision for Deferred Receivables account represents only those receivables deferred because they relate to appropriations for which expenditure authority has lapsed. The department does not compute its provision for deferred receivables based on what is estimated to be collectible within the next year.

Criteria: State Administrative Manual Section 7620 defines the Provision for Deferred Receivables account as the provision for receivables that will not be collected within one year. It further states that agencies will analyze their receivable balances at the end of the year and make an adjustment for the amounts to be deferred for financial statement purposes.

Recommendation: The department should analyze its receivable balances at the end of the year to determine which amounts are likely to be collected during the ensuing fiscal year. Amounts not likely to be collected should be reserved in the Provision for Deferred Receivables account.

Item 19. **Failure To Disclose Significant Contingent Liabilities and Liabilities Payable from Future Appropriations**

Finding: Although the department knew of them at the time the financial statements were issued, the department failed to disclose in its financial statements several significant contingent liabilities and liabilities payable from future appropriations. One liability that the department's legal office determined to be payable from a future appropriation totaled approximately \$62 million. The State's financial statements cannot be fairly presented without adequate disclosure of significant contingent liabilities and real liabilities payable from future appropriations.

Criteria: State Administrative Manual Section 8751 requires that all contingent liabilities and liabilities payable from future appropriations be reported by memorandum accompanying the financial statements at the end of the year.

Recommendation: Before issuing the financial statements at the end of the year, the department should determine whether there are any liabilities that should be disclosed.

Item 20. **Inappropriate Organizational Status for Department's Internal Auditors**

Finding: The department's Internal Audit Unit does not report to the appropriate level of management. Before March 1983, the Internal Audit Unit was part of the department's Audit Bureau, which reported to the Deputy Superintendent for Administration. In March 1983, an interim reorganization placed the Internal

Audit Unit within the Administrative Services Unit. The Administrative Services Unit reports at an organizational level significantly lower than the deputy level.

Criteria: State Administrative Manual Section 20020 provides that internal audit units should have organizational status sufficient to permit the accomplishment of its audit responsibilities.

Recommendation: The department's internal auditors should report directly to a deputy of the department.

Item 21. **Incorrect Vacation Pay for Separated Employee**

Finding: An employee leaving the department was not paid for approximately \$1,850 of accumulated vacation pay. The department had arranged to pay the employee in installments but misreported to the State Controller Payroll and Personnel Services Division the number of hours to be paid. The department's system of review over these transactions did not detect the error. After we informed them of the error, department staff took the necessary corrective action.

Criteria: Good internal control dictates that accumulated vacation pay be carefully computed and that it be reviewed for accuracy by a supervisor.

Recommendation: The department should continue its system of supervisory review over vacation to be paid to employees leaving the department. Also, due to the complexity of the computations, the department should consider using a standardized computation worksheet.

Item 22. **Variance Allocation Process Questionable**

Finding: During the year, the department allocates estimated costs for staff benefits by using the standard cost system. At the end of the year, the standard cost system reallocates the variance created by the difference between the actual costs incurred and the estimated costs recorded. Using the formula provided by management, we were not able to recompute the variance allocation computed by the standard cost system. We could not determine if there was an error in the standard cost system allocation of the variance or if management's description of the process was not accurate. As a result, the department cannot be assured that the standard cost system is allocating the variance as management intends.

Criteria: According to management, the standard cost system is designed to allocate staff benefits equitably among all units. Management's policy is to charge each unit for staff benefits according to the ratio of the unit's total salaries and wages to the department's total salaries and wages.

Recommendation: The department should review the standard cost system to determine if it is operating as management intends.

Item 23. **Inefficient Accounting and Reporting for Federal Grants**

Finding: The California Statewide Accounting and Reporting System (CALSTARS) is the department's financial accounting and reporting system. The department accounts for all federal grants in the CALSTARS grant project file. The department also accounts for some federal grants using manually maintained ledger cards.

During the first year of the CALSTARS' operation, the department made errors in entering data into the grant project file; these errors have never been corrected. Consequently, the department does not consider its CALSTARS records to be reliable for all grants. As a result, the department prepares its Federal Financial Status reports for some grants using the CALSTARS, but it prepares reports for other grants using either the manually maintained ledger cards, or a combination of both the CALSTARS and the ledger cards. Using two accounting systems concurrently to generate reports is a duplication of effort.

Criteria: Attachment G of U.S. Office of Management and Budget Circular A-102 requires that the department's financial management system provide accurate, current, and complete information.

Recommendation: The department should correct the errors in the CALSTARS grant project file as soon as possible so that it can use the CALSTARS in accounting and reporting for federal grants.

Item 24. **Inadequate Documentation for Financial Status Report**

Finding: The department does not maintain adequate supporting documentation for amounts included in the Financial

Status Report for certain grants. Additionally, the department was late in filing reports for most grants. We noted the following specific deficiencies:

- The department's Vocational Education Unit prepared the Financial Status Report for its 1980-81 vocational education grants using estimates that were not supported by the unit's accounting records. Also, the accounting records of the Vocational Education Unit did not reconcile with the records of the Accounting Office. As a result, we could not determine the propriety of the amounts reported on the Financial Status Report.
- At the time of our review, the department had submitted its "final" Financial Status Report for the 1981-82 child nutrition grants, but the amounts reported in the final report were not supported by the accounting records. However, before our review, the department advised the U.S. Department of Agriculture that the report was not correct and that the department intended to submit an amended final report. As of the end of our fieldwork, the department had not completed the amended report.
- During fiscal year 1982-83, the department was late in preparing 46 of the 52 Financial Status Reports due. In one case, the department prepared the report 13 months after the due date required by federal regulations.

Criteria: Attachment H of U.S. Office of Management and Budget Circular A-102 requires that annual Financial Status Reports be submitted within 90 days after the end of the reporting period.

Recommendation: The department should reconcile the Financial Status Report to the accounting records and retain schedules supporting any adjustments. In addition, the department should prepare and submit the Financial Status Reports on time.

Item 25.

Inadequate Follow-up of Audit Exceptions

Finding: The department's Audit Bureau does not adequately follow up on audit exceptions applicable to federal programs. These exceptions were identified by outside CPAs during their annual audits of local educational agencies (LEAs).

Of the 74 exceptions we selected for review, 38 had not been adequately resolved between the Audit Bureau and the LEAs. The Audit Bureau did not adequately follow-up on 28 of the exceptions that had been referred to the LEAs: 19 responses from the LEAs were unacceptable; 9 exceptions received no response. The Audit Bureau did not take sufficient action to ensure that acceptable responses would be received. Ten of the exceptions had not been referred to the LEAs to see if they had taken corrective action.

In addition, although audit exceptions are also supposed to be referred to the appropriate program unit for resolution, the Audit Bureau did not refer 21 of the audit exceptions. The Audit Bureau received a response on only 32 of the 53 exceptions that it referred. The Audit Bureau did not take sufficient action to ensure that it would receive responses. Because it does not adequately follow-up on audit exceptions, the department cannot ensure that LEAs are spending federal funds in accordance with federal regulations.

Criteria: The U.S. Office of Management and Budget requires that the department establish a system to follow-up on questioned costs, weaknesses in internal control systems, and other audit exceptions reported by outside CPAs during their annual audits of LEAs.

Recommendation: The department should establish procedures to ensure that it conducts an adequate follow-up on audit exceptions. The department should also consider computerizing the basic functions of the follow-up process. This would make staff available to ensure that the proper follow-up takes place.

Item 26. **Lack of Enforcement of Biennial Audit Requirement**

Finding: The department's Office of Child Nutrition Services does not enforce the biennial audit requirements for residential child care institutions and private schools participating in the National School Breakfast and Lunch Programs and the Special Milk Program. We found that 19 of the 21 institutions and schools required to have biennial audits are not submitting audit reports to the department. The Office of Child Nutrition Services is working with the U.S. Department of Agriculture to bring the residential child care institutions and private schools in compliance with the audit requirements.

Criteria: Code of Federal Regulations, Title 7, Part 220.15, requires that participants receiving reimbursements of more than \$10,000 annually from the National School Breakfast and Lunch Programs and the Special Milk Program must submit an audit report to the State Department of Education every two years.

Recommendation: The department should ensure that the Office of Child Nutrition Services continues to work with the U.S. Department of Agriculture to bring residential child care institutions and private schools in compliance with the established audit requirements.

Item 27. **Inadequate Review of LEA Applications for Federal Funding**

Finding: The department does not consistently follow its procedures for reviewing and approving LEAs' applications for funds provided by the Education Consolidation and Improvement Act of 1981 and by the Migrant Education Program.

We reviewed 50 LEA applications for funds under the Education Consolidation and Improvement Act of 1981. We found that 3 of the applications did not contain signed assurances of the eligibility of the participants, the equitability of services provided to participants, and the types of educational services provided.

To apply for Migrant Education Program funds, LEAs submit an application that is reviewed by the department's Office of Migrant Education (OME). We found that the checklist that the OME uses in reviewing applications is not always completed and that the OME approved applications before receiving all the required information. For example, in a sample of 50 applications, we found that 6 did not have all the necessary signatures, 8 did not meet the requirement that migrant parents constitute at least two-thirds of the Parent Advisory Council, 7 did not adequately describe Parent Advisory Council training, 5 did not describe Parent Advisory Council involvement, and 8 did not contain supporting computation sheets for all budget line items. The OME did not adequately follow-up to ensure that the LEAs complied with the application requirements.

Criteria: Public Law 97-35, Sections 556 and 566, require that LEA applications for funds include signed assurances of the eligibility of participants, the equitability of services provided to participants, and the types

of educational services provided through the use of funds under the Education Consolidation and Improvement Act of 1981.

Code of Federal Regulations, Title 34, Parts 204.30, 204.32, and 204.33, require LEAs to submit project applications for Migrant Education funds to the State Department of Education. The LEAs are to complete the application according to the instructions that the department provides. The department should review the applications to ensure that LEAs are operating their programs in compliance with federal regulations.

Recommendation: The department should adhere to its established procedures for reviewing LEA applications for federal funds, and it should not approve applications until it receives all the required information.

Item 28.

Inadequate Monitoring of the Migrant Education Program

Finding: During fiscal year 1982-83, the department's Office of Migrant Education (OME) did not adequately monitor LEAs to ensure that they were serving only eligible current or former migrant children under the program or to ensure that they were using Migrant Education Program funds only to supplement nonfederal funds. OME personnel did not conduct on-site visits to LEAs to review eligibility documents or to verify that program funds were being used to supplement and not to supplant federal funds. Without these on-site visits, the OME cannot ensure that LEAs are in compliance with federal regulations.

Further, a federal audit conducted in March 1983 determined that the OME did not adequately document the eligibility of children participating in the Migrant Education Program. At the time of our review, the OME was implementing procedures to properly identify children's eligibility. Therefore, we could not determine the adequacy of the OME's procedures.

Criteria: Code of Federal Regulations, Title 34, Part 204.3, defines current and former migratory children, and Parts 204.30 and 204.50 require the department to monitor LEAs to ensure that they comply with the requirements for spending funds under the Migrant Education Program.

Recommendation: The department should ensure that the Office of Migrant Education conducts on-site visits and implements its procedures to properly identify children eligible to participate in the Migrant Education Program. Also, the OME should ensure that the LEAs properly spent federal funds.

Item 29.

Unapproved Indirect Cost Rates

Finding: During fiscal year 1982-83, the department allocated indirect costs for all federal programs using rates other than those that it had submitted to the federal government in the Provisional Indirect Cost Rate Proposal. Although the department will have to amend the original rates to claim the proper amount of indirect costs for the year, the department never informed the federal government that it had amended the rates stated in the Provisional Indirect Cost Rate Proposal. Any changes in the rate should also be submitted for approval.

In addition, the department did not use the final indirect cost rate that it submitted to the federal government for the 1980-81 Bilingual Education Financial Status Report. As a result, the department overstated indirect costs by approximately \$22,200. Department officials could not explain how they determined the rate used for this report.

Criteria: Federal Management Circular 74-4 requires that a plan for allocation of costs be submitted for approval to the federal government.

Recommendation: The department should allocate costs to federal programs using only those indirect cost rates that it submits for approval to the federal government.

Item 30.

Failure To Notify LEAs of Block Grant Audit Requirements

Finding: The department has not notified the LEAs of the audit requirements for the Education Consolidation and Improvement Act Chapter 2 block grant. The State is responsible for ensuring that the LEAs and their auditors are advised of the block grant audit requirements.

The Department of Finance is currently revising its school audit manual entitled, "Standards and Procedures for Audits of California Local Educational Agencies." The revised school audit manual will

contain the requirements for auditing funds from block grants as well as other federal programs.

Criteria: The federal government's "Uniform Requirements for Grants to State and Local Governments, Compliance Supplement," makes the State responsible for assuring that the Education Consolidation and Improvement Act Chapter 2 block grant is included in the financial and compliance audits of LEAs.

Recommendation: The department should work with the Department of Finance to ensure that the LEAs and their auditors are notified of the block grant compliance requirements in time for the 1983-84 audits.

Item 31.

Federal Audit Exceptions Not Yet Resolved

Finding: As we reported in our report titled "Weaknesses in Internal Controls of State Agencies," dated August 1983, certain U. S. Department of Education audit reports cite the department for not recording costs in accordance with the federal regulations that require each grant to be accounted for and reported on separately. The audit reports conclude that the State's method of accounting for federal funds resulted in the department using lapsed funds. The department maintains that its method of commingling funds belonging to different grant years and using the "oldest" funds first is acceptable. The department continues to account for federal funds in this manner. As of December 1983, department officials said that this issue is still being resolved through negotiations between the department and the federal government.

Criteria: Section 74.61 of Subpart H of Appendix B to the U.S. Education Department General Administrative Regulations require that each grant be accounted for and reported on separately.

Recommendation: The department should continue to work with the U. S. Department of Education to resolve this audit issue.

EMERGENCY MEDICAL SERVICES AUTHORITY

The Emergency Medical Services Authority administers one of the 49 federal grants we reviewed. It is the U.S. Department of Health and Human Services Preventive Health and Health Services Block Grant, Federal Catalog Number 13.991.

Item 1. The Authority Has Not Complied with Federal Auditing Requirements

Finding: The three subrecipients that receive federal funds through the authority under the Preventive Health and Health Services Block Grant were audited, but not in accordance with the Comptroller General's standards. Consequently, we were unable to determine whether the subrecipients fulfilled the requirements of the Preventive Health and Health Services Block Grant.

Criteria: Federal law (42 U.S.C. 300w-5(b)(2)) states that each state must annually audit the expenditures it makes from payments received under Section 300w-2 of this title. Such audits must be conducted in accordance with the Comptroller General's standards.

Recommendation: The authority should require subrecipients to ensure that auditors of subrecipients comply with the audit standards of the Comptroller General.

Item 2. Contracts with Subrecipients Do Not Detail Allowable and Disallowable Costs

Finding: The authority does not detail allowable and disallowable costs in contracts with subrecipients that receive funds from the Preventive Health and Health Services Block Grant. Because the contracts lacked sufficient detail, we were unable to determine whether subrecipients fulfilled the requirements of the Preventive Health and Health Services Block Grant.

Criteria: Federal law (42 U.S.C. 300w-3(b)) requires that a state not use amounts paid to it under Section 300w-2 for any unallowable uses. Therefore, the authority should define allowable and disallowable costs in contracts with subrecipients.

Recommendation: The authority should immediately provide subrecipients with policy statements that define and list allowable and disallowable costs.

EMPLOYMENT DEVELOPMENT DEPARTMENT

The Employment Development Department administers 6 of the 49 federal grants we reviewed. They are the U.S. Department of Agriculture grant, Federal Catalog Number 10.551; U.S. Department of Labor grants, Federal Catalog Numbers 17.207, 17.225, and 17.232; U.S. Department of Health and Human Services grant, Federal Catalog Number 13,646; and U.S. Treasury grant, Federal Catalog Number 98.010.

Item 1. Incorrect Accounting for Revenues and Reimbursements

Finding: In the Unemployment Fund, Unemployment Compensation Disability Fund, and Contingent Fund, receivables that are due from employers or claimants and that are estimated to be collected within one year were not shown as revenues or reimbursements of the current year. Likewise, Unemployment Administration Fund receivables that are due from local governments and other state agencies and that are estimated to be collected within one year were not shown as revenues or reimbursements of the current year.

Failure to accrue revenues in the proper year distorts the department's financial statements and makes these financial statements inconsistent with those of other state agencies.

Criteria: State Administrative Manual Section 10591 states that revenue should be accrued at June 30 of each year when that revenue is estimated to be collected within one year.

Recommendation: The department should recognize as revenues or reimbursements of the current year all amounts that are recorded as receivable and that are estimated to be collected within one year.

Item 2. Inadequate Year-End Adjustments to Revenue Allocations

Finding: The department's Fiscal Programs Division did not record the necessary adjustments to the revenue accounts in the Unemployment Compensation Disability Fund and Employment Tax Fund.

The Central Cashiering Group initially allocates daily tax collections to the various funds using estimates based on past experience. When the Data

Processing Division processes the tax returns, it identifies the actual allocations. The Accounting Controls Group then makes adjustments to offset the negative balances created by other daily adjustments. However, the Fiscal Programs Division did not reverse these adjustments to reflect proper revenue account balances of each fund at June 30, 1983. This resulted in a \$2.7 million overstatement of revenues of the Employment Tax Fund and a corresponding \$2.7 million understatement in the Unemployment Compensation Disability Fund.

Criteria: Good accounting practices require that collections received be recorded as revenues in the proper funds at June 30 of each year.

Recommendation: The Fiscal Programs Division should establish procedures to ensure that adjustments to revenue are recorded in the proper funds at the end of the year.

Item 3.

Inadequate Accrual of Year-End Obligations

Finding: The department understated its June 30, 1983, accounts payable balance in the Unemployment Administration Fund by a net total of \$1,036,876. This error resulted because the department did not accrue valid contract obligations at June 30, 1983, leading to an understatement of \$3,614,265, and because the department did not adjust the percentage rates used to compute unemployment insurance contributions payable, leading to an overstatement of \$2,577,389.

Criteria: State Administrative Manual Section 10584 requires that outstanding encumbrances be analyzed to determine valid obligations at June 30. In addition, good accounting practices require that percentage rates used in making year-end estimates be periodically updated to ensure proper reporting of accruals.

Recommendation: At June 30, the department should analyze the outstanding encumbrances of the Unemployment Administration Fund to determine the amount of valid obligations. In addition, the department should periodically update the percentages used to compute the unemployment insurance contributions payable.

Item 4.

Inadequate Support for General Ledger Balances

Finding: The department did not prepare a detail listing of the general ledger balances for Accounts Receivable, Unapplied Remittances, and Accounts Payable at June 30, 1983. Further, the department did not reconcile the subsidiary ledger balance for the Accounts Payable account to the general ledger balance.

Criteria: State Administrative Manual Section 7960 requires that agencies retain a detail listing to support the general ledger account balances as of June 30. Also, good internal accounting practices require that general ledger balances be supported by detail subsidiary records that are periodically reconciled to the general ledger.

Recommendation: The department should maintain a detail listing to support the general ledger balances for Accounts Receivable, Unapplied Remittances, and Accounts Payable, and should periodically reconcile these subsidiary records to the general ledger.

Item 5.

No Detail Support for Outstanding Checks in the Unemployment Fund

Finding: The department did not prepare detailed check listings to determine and report the amounts for outstanding checks on the bank reconciliations for accounts 095 and 800.

Criteria: State Administrative Manual Section 7921.1 requires that the amount of outstanding checks be supported by listings that show the number, date, and amount of each outstanding check.

Recommendation: The department should prepare detail listings of outstanding checks and use these listings as support for the bank reconciliations.

Item 6.

Inadequate Safeguards over Program Documentation

Finding: The department does not adequately control access to the documentation of its computer programs. Program documentation is filed throughout the Data Processing Division in unlocked cabinets that are accessible to all department personnel. There are no procedures, such as a sign-out log, to limit access to these documents. Lack of control over access to program documentation could result in unauthorized modifications to data files and programs.

Criteria: Program documentation is a valuable asset that should be subject to restricted access. State Administrative Manual Section 4845.71 states that program documentation should be kept in controlled environments with security measures to deny access by unauthorized persons.

Recommendation: The department's Data Processing Division should implement procedures to ensure restricted access to program documentation.

STATE BOARD OF EQUALIZATION

Item 1. Weaknesses in Internal Control over the Distribution of Revenues to Cities and Counties

Finding: The retail sales tax revenues that were distributed to cities and counties for the third quarter of 1982 were in error. The reconciliation processes at the board's EDP Control Unit and its Local Tax Unit failed to detect errors in the distribution. Consequently, the board underpaid cities and counties by \$1.1 million. After we discussed this error with staff of the Local Tax Unit in September 1983, the board adjusted revenue distribution for the second quarter of 1983.

Criteria: An effective reconciliation process should assure that transactions are processed and recorded correctly.

Recommendation: The board should strengthen the reconciliation process at both the EDP Control Unit and the Local Tax Unit to ensure proper distribution of retail sales tax revenues to local governments.

Item 2. Inadequate Check-Out and Clearance Procedures for Employees Leaving Agency Employment

Finding: The board releases salary warrants of employees leaving agency employment even though the employees have not completed the Clearance/Separation form. Consequently, the board cannot assure accountability for outstanding advances to employees or for state-owned items such as credit cards, keys, and equipment.

Criteria: State Administrative Manual Section 8580.4 states that salary warrants will not be distributed to an employee leaving agency service until the agency is assured that all outstanding travel and salary advances have been paid.

Recommendation: The board should strengthen its check-out and clearance procedures so employees leaving agency employment complete the Clearance/Separation form before they receive their final salary warrants.

Item 3. **Lack of Participation by the Internal Auditors During the Design and Development of Electronic Data Processing System**

Finding: Internal auditors do not actively participate in reviewing the EDP systems of internal control during the design and development of those systems. Without this internal audit review, the board cannot assure that the necessary controls are in place to provide proper and efficient operations.

Criteria: Generally accepted EDP controls require that users and internal auditors actively participate in designing and developing EDP systems.

Recommendation: The board should require its internal auditor to review the systems of internal control for data processing systems during the design and development of these systems.

Item 4. **Inadequate Electronic Data Processing Back-Up Procedures**

Finding: The board has not arranged to use the EDP equipment of other data centers to ensure continued processing of sales tax returns if its own data processing equipment cannot function. As a result, the State could lose revenues and there could be delays in the distribution of retail sales tax revenues to local governments.

Criteria: State Administrative Manual Section 4909.8 states that departments having critical EDP systems involving collection of income must ensure that back-up procedures are in place.

Recommendation: The board should conduct a comprehensive risk analysis of its EDP system and consider establishing back-up procedures for that system.

DEPARTMENT OF FORESTRY

Item 1. Late Financial Statements

Finding: The department did not submit its financial reports to the State Controller until December 9, 1983, approximately four months after the due dates specified in the State Administrative Manual. Failure to submit financial reports when due delays the State Controller in compiling complete financial reports for the State of California.

Criteria: State Administrative Manual Section 7990 requires agencies to submit financial reports by July 20 and August 20 for Governmental Cost Funds and Non-Governmental Cost Funds, respectively.

Recommendation: The department should submit its financial reports to the State Controller by the dates required by the State Administrative Manual.

Item 2. Inadequate Separation of Duties

Finding: The department does not provide adequate separation of duties in its accounting division. Duties that are incompatible are frequently performed by several employees. For example, the cashier and others who receive cash make bank deposits, maintain the receipts register, authorize disbursements and mail or distribute checks. Unless such duties are properly separated, employees could conceal irregularities and responsibility for errors cannot be determined.

Criteria: Good internal control requires an adequate separation of duties and fixed responsibilities within the accounting division to prevent errors or irregularities.

Recommendation: The department should separate incompatible duties in the accounting division and assign duties to specific individuals.

Item 3. Untimely Reconciliation of Revolving Fund Advance

Finding: During fiscal year 1982-83, the department did not prepare a monthly reconciliation of its revolving fund since November 1982. A monthly reconciliation of the revolving fund is an integral part of the

department's internal control. Failure to promptly reconcile the revolving fund may prevent prompt detection of errors or irregularities.

Criteria: State Administrative Manual Section 7922 requires monthly reconciliation of revolving fund advances.

Recommendation: The department should prepare timely monthly reconciliations of its revolving fund advance.

Item 4.

Inadequate Control over CALSTARS EDP Functions

Finding: The department's controls over CALSTARS EDP functions are inadequate. We noted that personnel who maintain and input documents also reconcile output control totals. Also, accounting personnel do not maintain control over processing and reconciliation of control totals. In addition, master file and transaction files are not safeguarded from unauthorized changes by requiring separate passwords for all employees. Finally, the application software and subsequent changes thereto are not documented.

Because of these weaknesses over the CALSTARS EDP functions, the department lacks assurance that financial reports are reliable.

Criteria: Good internal control requires reasonable assurance that assets are safeguarded, and that financial records are reliable.

Recommendation: The department should separate duties to provide adequate controls over CALSTARS EDP functions to ensure that assets are safeguarded and that financial reports are reliable. In addition, separate passwords for users of the CALSTARS should be required to preclude unauthorized access to the system.

Item 5.

The Department's CALSTARS Reports Are Not Reliable

Finding: The department established its program cost accounts using inaccurate formulas for cost allocation, labor distribution, and fund split. As a result, the department's CALSTARS reports are not reliable. Without reliable reports, the department may not be able to accurately determine expenditures for reimbursement from the federal government and from local governments.

Criteria: Government Code Section 13300 requires CALSTARS agencies to account for expenditures by line item, program, governmental unit, and fund source through the CALSTARS reporting system. Indirect costs are to be allocated by the system based upon predetermined formulas developed by the department.

Recommendation: The department should accurately establish its program cost accounts to ensure that its CALSTARS reports are reliable so that it can accurately determine federal or local government reimbursements.

Item 6. **Use of Unauthorized Bank Draft Purchases**

Finding: The department's use of its bank draft purchase system includes the following practices that are not authorized by the State Administrative Manual: purchases when immediate payment is not necessary, purchases when the transaction is not over-the-counter, payments when alternate payment methods are available, payments for charged purchases, and use of bank drafts by headquarters personnel.

Criteria: State Administrative Manual Section 8124 provides that the bank draft purchase system should not be used when immediate payment is not necessary, when purchase transactions are not over-the-counter, or when alternate payment methods are available. In addition, Section 8124 provides that the bank draft purchase system is not to be used for charged purchases or by headquarters personnel.

Recommendation: The department should not use its bank draft purchase system for purposes other than those authorized by the State Administrative Manual.

Item 7. **Payments Made without Vendor Invoices**

Finding: The department's regional offices submit copies of subpurchase orders and bank draft vouchers to headquarters for payment. These documents, instead of vendor invoices, are forwarded by headquarters to the State Controller. Duplicate payments have occurred when vendor invoices were also submitted for payment.

Criteria: State Administrative Manual Section 8422.1 requires state agencies to submit original vendor invoices to the State Controller for payment. This section also authorizes agencies, under certain conditions, to

submit copies of invoices if the agencies cannot obtain original invoices.

Recommendation: The department should require its regional offices to submit vendor invoices for payment as required by the State Administrative Manual.

Item 8. **Inadequate Collection Procedures**

Finding: The department does not aggressively pursue collection of overdue receivables; staff members are not assigned specific responsibility for pursuing collections. As a result, the department's probability of collecting overdue receivables is decreased. The amount of overdue receivables has not been determined, however, the total reportable receivable balance as of June 30, 1983, is approximately \$13.6 million.

Criteria: State Administrative Manual Section 8776.5 requires agencies to provide for prompt collection of receivables.

Recommendation: The department should assign collection responsibilities to specific staff members and follow the State Administrative Manual procedures to aggressively pursue collection of receivables.

Item 9. **Inadequate Separation of Duties for Payroll**

Finding: Department employees who certify employee attendance reports and process other payroll documents also receive and distribute salary warrants. Unless these duties are separated, employees may authorize fictitious payroll payments.

Criteria: State Administrative Manual Section 8580.1 requires the separation of incompatible payroll duties.

Recommendation: The department should comply with the State Administrative Manual and assign incompatible payroll duties to separate employees.

FRANCHISE TAX BOARD

Item 1. Unreported Liabilities for Prepayments of Protested Assessments and for Tax Overpayments

Finding: The board did not report liabilities of up to \$134 million on its financial statements for the fiscal year ended June 30, 1983. These liabilities comprise prepayments of protested tax assessments and tax overpayments made by taxpayers. The \$134 million represents the amount of taxpayer dollars that the board may have to return to the taxpayers.

The board does not record these liabilities for two reasons. First, the board does not recognize a liability for prepayments of protested assessments. Instead, the board records these prepayments as a credit balance in the Accounts Receivable account. Second, the board does not recognize a liability for tax overpayments until it refunds the overpayment. Furthermore, the board does not maintain adequate documentation of tax overpayments to permit a reasonable estimate of refunds payable to taxpayers.

Criteria: State Administrative Manual Section 8242 states that "all refund claims against Governmental Cost Funds will be debited to the revenue account of the fiscal year current at the time the agency files the refund claim." Although the board's practice is in accordance with the State Administrative Manual, we believe that the liability for these overpayments should be recognized in the current fiscal year. This position is supported by the generally accepted accounting principle that liabilities be recorded when the obligation is incurred.

State Administrative Manual Section 8776.4 states that prepayments of claims are not receivables and should not be set up as a credit to the Accounts Receivable. Instead, prepayments should be treated as revenue collected in advance or as a liability until the transaction is complete.

Recommendation: The board should maintain adequate documentation of tax overpayments to permit a reasonable estimate of refunds payable to taxpayers at year end. In addition, the board should comply with Section 8776.4 of the State Administrative Manual and account for prepayments of protested assessments as a liability until the transaction is complete.

The Department of Finance should revise the State Administrative Manual so that tax overpayments are accounted for in accordance with generally accepted accounting principles.

Item 2.

Inadequate Control over Cash Receipts and Returned Warrants

Finding:

The board has not established adequate procedures to account for incoming cash receipts. Specifically, the board does not prelist returned refund warrants or restrictively endorse checks and warrants to establish accountability at the point of first receipt. We also found that the board does not use a transfer receipt document when warrants are transferred between employees. Prelisting of incoming warrants provides documentation to aid in determining that the correct amounts of cash are deposited. A restrictive endorsement safeguards the checks and warrants in the event of theft or loss. A transfer receipt document provides greater accountability over internal cash movements.

Criteria:

State Administrative Manual Section 8020.1 requires agencies to prepare prelistings of all incoming receipts consisting of cash and negotiable instruments to localize accountability. Section 8034.1 requires state agencies to restrictively endorse checks and warrants on the day they are received. Furthermore, Section 8021 of the State Administrative Manual requires agencies to use transfer receipts whenever cash or other cash items are transferred between employees.

Recommendation:

The board should establish accountability for cash items at the point of first receipt and require the use of a transfer receipt when cash is transferred between employees.

Item 3.

Inadequate Fire Contingency Plan

Finding:

The board does not have an adequate contingency plan to safeguard checks and documents against loss in the event of fire. The board processes millions of checks and documents through its receiving area each year. Although the checks and documents are highly susceptible to loss due to fire or water damage from the overhead sprinkler system, they are left unprotected on desk tops.

Criteria: Good internal control requires that all assets be adequately safeguarded against loss.

Recommendation: The board should identify areas that might sustain heavy loss in the event of a fire and develop a contingency plan to safeguard checks and documents in these high-risk areas.

Item 4. **Improper Posting of Due to Other Funds Account**

Finding: The board does not properly record transactions in the "Due to Other Funds" account of the Personal Income Tax and Bank and Corporation Tax funds. Although the board properly records the liability when tax payments are collected for the General Fund, the board does not reduce the liability when the tax revenues are subsequently transferred to the General Fund. As a result, the account balance is misstated during the year.

Criteria: State Administrative Manual Section 10440 states that the "Due to Other Funds" account should be credited when a liability is created and debited when funds are transferred.

Recommendation: The board should comply with Section 10440 of the State Administrative Manual crediting the "Due to Other Funds" account when a liability arises and debiting the account when funds are transferred. Further, the board should record revenue and transfer information in memo accounts.

Item 5. **Inadequate Control of the Credit Follow-Up Referral Report**

Finding: The board does not exercise adequate control over the Bank and Corporation Tax Fund "Credit Follow-Up Referral" report. The Credit Follow-up Referral report is a listing of all credit balances on the Accounts Receivable masterfile and is used to issue refunds to taxpayers. The report is not kept in a secure location nor is access to the report adequately restricted. Further, the board does not keep a record of the final disposition of the credit balances. As a result of these weaknesses, an employee could use the information on the report to issue fraudulent refunds. Because the board does not maintain records of the disposition of the credit balances, this misuse could go undetected.

Criteria: Good internal control restricts access to sensitive data and provides adequate assurance that errors and irregularities are detected in a timely manner.

Recommendation: The "Credit Follow-up Referral" report should be stored in a secure location; access to the report should be restricted to those employees assigned to work the credit balances. Finally, the board should maintain a record of the disposition of the credit balances.

Item 6. **No Formal Procedures To Verify Automated Claims Schedules**

Finding: The Corporate Transactions Unit has not formalized procedures to verify the accuracy of computer-generated claims schedules prior to authorizing payment. Because there was no procedure to verify the accuracy of computer-generated claims schedules in November 1982, the unit authorized the payment of duplicate refunds totaling \$4 million. Following this incident, the unit established informal procedures to verify the accuracy of the automated claims schedules; however, these procedures have not been formalized.

Criteria: Organizational policies and procedures should be well documented.

Recommendation: The Corporate Transactions Unit should formalize their procedures for verifying the accuracy of automated claims schedules.

DEPARTMENT OF GENERAL SERVICES

Item 1.

Lump Sum Separation Payments Are Inaccurate

- Finding: The department's personnel office staff incorrectly calculate lump sum separation payments. Six of the fifteen separations we tested had errors in the calculation of projected accumulated leave hours. These errors resulted in four overpayments totaling \$565.64 and two underpayments totaling \$496.86. Consequently, the department is making excess payments that could be difficult to collect and the department is still liable for amounts owed to separated employees.
- Criteria: State Personnel Board Personnel Transaction Manual Section 623 prescribes the correct method for calculating lump sum payments, including how to project accumulated leave hours.
- Recommendation: The department should provide additional training to its personnel assistants in computing lump sum separation payments. In addition, the department should require that supervisory personnel review each lump sum calculation.

Item 2.

Inadequate Separation of Payroll Duties

- Finding: Department employees who process attendance and other payroll documents also handle undistributed salary warrants. Unless these duties are separated, an employee could authorize a fictitious payment for personal use.
- Criteria: State Administrative Manual Section 8580.1 requires that persons who receive salary warrants, distribute salary warrants to employees, or handle warrants for any other purpose, should not be authorized to process or sign personnel documents.
- Recommendation: The department should assign the safekeeping of undistributed salary warrants to employees other than those who certify or process payroll and personnel documents.

Item 3. **Controls over the Stock Inventory System Are Not Adequate**

Finding: The on-line stock inventory system at the Office of State Printing does not require a password sign-on before a person can gain access to or override the data file. In addition, there are no edit checks in the system to produce error listings when inventory is carried at negative or zero balances or when significant unit price fluctuations occur. As a result, significant errors or irregularities in the carrying value of inventory could remain undetected.

Criteria: State Administrative Manual Sections 4846.5 and 4846.6 require strict security measures to guard against the unauthorized access to data files and against processing errors in electronic data processing systems.

Recommendation: The Office of State Printing should implement password control over access to the on-line stock inventory system. It should also add internal edit checks to the system such as reasonableness checks.

Item 4. **Work-in-Process Inventory Balance Is Overstated**

Finding: The Office of State Printing included in the balance of work-in-process inventory at June 30, 1983, a large number of printing jobs that were completed and shipped prior to June 30, 1983. As a result, work-in-process inventory was overstated and cost of goods sold as well as revenue were understated. Office of State Printing personnel identified some of these jobs and disclosed them on the financial statements as "Jobs Pending Closure." However, in our sample of 150 work-in-process jobs, we discovered 20 jobs that the office shipped prior to June 30, 1983, but did not identify as "Jobs Pending Closure." Because it was impractical for us to identify all errors in the account balance, we could not determine the amount of overstatement of the work-in-process inventory.

Criteria: Generally accepted accounting principles define work-in-process inventory as including only the cost of partially completed products manufactured or processed.

Recommendation: The Office of State Printing should develop procedures to identify all completed jobs as part of the normal monthly billing cycle and should remove completed jobs from the work-in-process inventory.

Item 5.

Accumulated Depreciation Is Overstated

Finding: The Office of State Printing has not adjusted the group depreciation rates for changes in the estimated service lives of equipment. As a result, some equipment has been depreciated for a period substantially longer than the originally estimated service life. This overdepreciation has caused accumulated depreciation to be overstated, and net fixed assets to be understated, by at least \$1 million.

Criteria: Depreciation rates used in financial reporting should reflect actual service lives of the assets. When the group depreciation method is used, the group depreciation rate and the depreciable basis should be periodically reviewed to ensure that the group of assets is not significantly overdepreciated or underdepreciated.

Recommendation: Office of State Printing personnel should periodically review the group depreciation rates to determine whether any adjustments to the rates should be made to reflect changes in the estimated service lives or whether the depreciable basis should be reduced.

Item 6.

The Performance Appraisal Review Section Is Not in Compliance with All Internal Auditing Standards

Finding: The Performance Appraisal Review Section is not in compliance with the management standards of the Institute of Internal Auditors. Specific weaknesses include no documentation of supervisorial or managerial reviews of audit progress, workpapers or audit reports; no periodic appraisals of employee performance; and no standardized internal self-assessment program. As a result, management is not assured that the work performed is of the required quality or that all issues in an audit have been resolved.

Criteria: California Government Code Section 1236 requires all state agencies that conduct internal auditing activities to use the "Standards for the Professional Practice of Internal Auditing" published by the Institute of Internal Auditors. These standards require the proper management of the internal auditing department including a quality assurance program, periodic evaluation of employee performance, and development of an internal self-assessment program.

Recommendation: The Performance Appraisal Review Section should document all reviews of audit progress, workpapers and audit reports; maintain periodic evaluations of employee performance; and periodically assess its policies and procedures to determine whether any improvements can be made.

DEPARTMENT OF HEALTH SERVICES

The Department of Health Services administers 6 of the 49 federal grants we reviewed. They are the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 13.714, 13.856, 13.890, and 13.991; U.S. Department of Agriculture grant, Federal Catalog Number 10.557; and U.S. Environmental Protection Agency grant, Federal Catalog Number 66.506.

Item 1. Noncompliance with Federally Mandated Claims Sample

Finding: In its sample of paid medical claims for October 1982 through March 1983, the department omitted from its sample of claims that qualify for federal reimbursement various classifications of payments for medical benefits coded 03, 06, 07, 08, 10, 43, 86, and 87. The department uses its findings from this sample to estimate the amount of erroneous payments and to develop cost effective ways of eliminating erroneous payments for medical benefits. Because of an incomplete sample, the department could be incorrectly estimating the amount of erroneous payments.

Criteria: The federal government requires the department to sample payments for medical benefits for which the department receives federal reimbursements, identify the types and amounts of errors, and thus draw inferences about the payments.

Recommendation: The department should ensure that all claims that qualify for federal reimbursement are included in its sample universe.

Item 2. Unaudited Expenditures

Finding: The department is not able to audit the computation of payments for "crossover claims." Crossover claims are provider invoices that are first processed and partially paid by the federal government and then processed by the department. During fiscal year 1982-83, the department paid \$162 million for crossover claims. However, the department receives only summarized data from the federal government and does not have sufficient information to determine that the amount the federal government has paid was computed correctly. Consequently, the department

cannot determine that the State is paying only those amounts for which it is liable.

Criteria: Good internal control requires that the State be able to determine that it pays only those amounts for which it is liable.

Recommendation: The department should request that the federal government provide sufficient detail on the providers' invoices and on the amounts that the federal government has paid so that the department can conduct audits to assure that the State's liability is accurate.

Item 3. **Food Vouchers Are Not Reconciled in a Timely Manner**

Finding: The department does not promptly reconcile food vouchers issued to food vouchers redeemed under the Special Supplemental Food Program for Women, Infants, and Children (WIC). As of November 21, 1983, the August 1983 reconciliation was complete and the September 1983 reconciliation was in progress. To detect possible irregularities promptly, the department should complete the reconciliation in a timely manner.

The department does not promptly reconcile vouchers issued to vouchers redeemed because of the large number of transactions, a cumbersome reconciliation process, and an inadequate reconciliation format.

Criteria: Good internal control and federal regulations (7C.F.R. 246.11(h)) require that the records of food vouchers issued be reconciled against the records of food vouchers redeemed to control the accuracy of the records.

Recommendation: The department should promptly reconcile food vouchers issued to food vouchers redeemed, and it should establish a reconciliation format that includes all outstanding or unreconciled vouchers.

Item 4. **The Department Does Not Take a Periodic Physical Inventory of Food Vouchers**

Finding: The department maintains a perpetual inventory system of food vouchers, but it does not take a periodic physical inventory to determine whether food vouchers are damaged or missing. If no physical inventory is taken, missing or improperly issued food vouchers may go undetected. A physical inventory is especially

important since the department does not promptly reconcile food vouchers issued to food vouchers redeemed.

Criteria: Good internal controls require that a physical inventory of food vouchers be conducted periodically and that any differences from the accounting records be resolved and adjusted accordingly.

Recommendation: The department should perform a periodic physical inventory of food vouchers, and it should require that all purchased and issued food vouchers be accounted for.

Item 5. **Excessive Federal Funds On Hand**

Finding: The department's cash balances of federal funds for the Special Supplemental Food Program for Women, Infants, and Children (WIC) for the quarter ended June 30, 1983, exceeded that authorized by the federal government. During the quarter, the department had a combined average daily cash balance in the Public Health Federal Fund (WIC portion only) and the Food Voucher Revolving Fund of approximately \$4 million. This balance was sufficient to pay administrative and program expenditures for 10.8 working days.

Criteria: The Food and Nutrition Handbook 150, Section 2, authorizes the State to maintain a federal cash balance that is sufficient to meet the department's needs for three working days.

Recommendation: The department should ensure that federal cash on hand does not exceed the federally authorized limit.

Item 6. **Weaknesses in Accounting for Cash**

Finding: The department has not assigned responsibility for preparing and reviewing the monthly reconciliation of the department's general cash balance to the State Controller's records. Moreover, the reconciliation prepared for the period ended June 30, 1983, was incorrect because it did not include several deposits in transit, totaling \$76,000. As a result, the department's general cash balance was understated by that amount as of June 30, 1983.

Criteria: State Administrative Manual Section 8060 requires that departments reconcile their general cash accounts each month. Section 7921.1 requires that

the reconciliation include a list showing the date and amount of each deposit in transit. The list should include all deposits in transit.

Recommendation: The department should assign specific employees to prepare the monthly reconciliation of the general cash account. Additionally, the department should review the reconciliation to assure that it is prepared each month and that all deposits and other reconciling items are properly accounted for.

Item 7.

Payroll Processed without Certified Attendance Reports

Finding: The department releases regular payroll warrants without certified attendance reports from the program units. Some certified attendance reports were as much as six months late, and in some cases they were not received by the personnel unit. As a result, the department may be paying employees for time not worked. Additionally, leave times reported in the attendance reports were not promptly posted to the leave balance records.

Criteria: Payroll Procedures Manual Section 10.231 requires that the department report to the State Controller's office the actual time worked. Additionally, attendance report documents are due in the Personnel Office by the fifth work day of the month for the preceding pay period.

Recommendation: The department should obtain and review all attendance reports before releasing payroll warrants. The department has implemented procedures to notify unit chiefs when attendance reports are continuously late or in error.

Item 8.

Lump Sum Vacation Payments Are Not Computed Correctly

Finding: The department frequently does not correctly compute lump sum vacation payments for employees leaving the department. The department did not correctly compute 16 of the 30 payments that we tested. We found overpayments of \$417 and underpayments of \$979. The department does not update its leave balance records promptly because its employee attendance reports are late. Consequently, the personnel unit uses incomplete records in computing lump sum payments.

Criteria: Good accounting practice requires that lump sum vacation payments be supported by adequate documentation. The documentation should include an updated leave balance report and worksheet showing how the amount is computed.

Recommendation: The department should require that all leave amounts reported in attendance reports be posted to the leave balance reports before computing lump sum vacation pay, and that computations be adequately documented.

Item 9. **Weaknesses in Internal Controls over Disbursements**

Finding: The department did not adequately control certain disbursements related to medical benefits and employee travel. For instance, the unit responsible for processing refunds to medical providers did not always review the provider's invoices or compare the name of the payee on the warrant to the name on the invoice. Also, the department did not adequately control the distribution of travel checks to departmental employees, and it allowed travel checks to be picked up by unauthorized employees. Furthermore, the department did not always obtain two signatures when required for payments of \$15,000 and over. The department reported that each of these weaknesses resulted in a case of employee fraud and collusion. The department initially incurred a loss of approximately \$186,000 from these cases. We estimate that \$20,000 of the potential loss was federal funds. The losses are covered by a fidelity bond from the State's Office of Insurance and Risk Management, but the department is not sure to what extent the losses are covered.

Criteria: State Administrative Manual Section 8422.1 requires departments to audit invoices for propriety before submitting them to the State Controller's office for payment. Section 8422.6 specifies that warrants for travel costs should not be routed through the person who prepares or approves the travel claim. Section 8001.2 requires two signatures for all payments of \$15,000 or more to payees other than the State Treasurer, other state agencies, or as otherwise authorized by the Department of Finance.

Recommendation: During our audit work, the department began to take corrective action. The department has begun to require that all requests for refunds to medical providers have two signatures, including the originator and the supervisor of the unit requesting the payment, and that the request include the medical

provider's invoice. Also, the department now distributes a quarterly listing to section chiefs, requiring positive confirmation of employees' authorized travel and related costs. Furthermore, the department now requires two signatures for all revolving fund disbursements of \$15,000 and over to payees other than the State Treasurer, other state agencies, or as otherwise authorized by the Department of Finance.

Additionally, we recommend that the person who prepares the bank reconciliation, review paid revolving fund warrants to ensure that all payments over \$15,000 contain two authorized signatures.

Item 10

Expenditures Reported for the WIC Program Are Based on Estimates

- Finding: The department uses estimates instead of actual records in preparing the monthly Federal Financial Status Report (FSR) for the Special Supplemental Food Program for Women, Infants, and Children (WIC). Estimates are used since complete financial data cannot be compiled in a timely manner. The department does not revise the estimates as actual expenditures become known.
- Criteria: Federal Circular A-102, Attachment G requires that the grantee's financial management system provide for accurate, current and complete disclosure of the financial results of each grant program. Additionally, good accounting practices require that reported expenditures be supported by accurate accounting records. When estimates must be used in place of recorded accounting information, the estimates should be revised to include actual expenditures as these amounts become known.
- Recommendation: During our audit, the department advised us that beginning in fiscal year 1983-84, estimated expenditures reported in the Monthly Federal Financial Status Report are being revised on subsequent monthly reports to reflect actual expenditures. We recommend that the department continue to report actual expenditures to the federal government as these amounts become known.

Item 11.

**Final Federal Financial Status Report Not Reconciled
to Accounting Records**

Finding: The department did not reconcile the final Federal FSR for the federal Microbiology and Infectious Diseases Research grant, dated December 15, 1982, to the department's accounting records. The FSR shows \$208 more in expenditures than the department's accounting records.

Criteria: Circular A-102, Attachment G requires that the grantee's financial management system provide for accurate, current and complete disclosure of the financial results of each grant program.

Recommendation: The department should reconcile all differences between the Federal Financial Status Report and the department's accounting records.

HUMBOLDT STATE UNIVERSITY

Humboldt State University administers one of the 49 federal grants we reviewed. It is the U.S. Department of Interior grant, Federal Catalog Number 15.114.

Item 1. Inadequate Separation of Duties Involving Cash Transactions

Finding: We found inadequate separation of duties over the refund of fees and scholarship monies. One employee is responsible for authorizing the payment, preparing the check, and countersigning the check for the refund of fees and scholarship monies. Additionally, the same employee maintains the depositors ledger. Consequently, the employee could authorize a fictitious payment and direct the payment for personal use.

Criteria: State Administrative Manual Section 8080 specifies that employees who prepare checks should not also authorize disbursements or sign checks.

Recommendation: The university should assign the duties of authorizing disbursements and signing checks to an employee other than the one responsible for preparing checks and maintaining the depositors ledger.

Item 2. Inadequate Separation of Duties Involving Property

Finding: One employee who is assigned the duties of the property clerk is also assigned the duties of the inventory clerk. Unless these duties are separated, the university could lose equipment and not discover the loss.

Criteria: State Administrative Manual Section 8659 prohibits the custodian of property records from controlling or supervising inventories.

Recommendation: The university should assign the duty of counting inventory to employees other than those who maintain property records.

Item 3.

Locally Built Projects Are Not Recorded

Finding: The university's accounting office does not record the cost of locally constructed improvements and additions to university buildings and other structures in the property records. The university's Plant Operations department does not provide the accounting office with the costs that should be recorded.

Criteria: State Administrative Manual Section 8655.4 requires that locally built improvements or additions be recorded in the property ledger.

Recommendation: The university should develop and implement procedures for recording the cost of all locally built projects in the property records.

Item 4.

Inadequate Control over Attendance Reporting

Finding: The Office of the Dean, College of Business, submitted attendance reports during April, May, and June of 1983 on behalf of a teaching assistant who was no longer employed. The erroneous attendance reports were kept as a result of a lack of communication and coordination between the Office of the Dean, which is responsible for maintaining attendance reports, and the Department of Computer Information Systems, which is responsible for the hiring, supervision, and separation of its teaching assistants. The former teaching assistant declined to accept the warrants generated on the basis of these attendance reports and the university returned them to the State Controller.

Criteria: To avoid payments for services not performed, prudent business practice dictates that attendance reports be maintained only for current employees.

Recommendation: The university should verify that individuals are working or are on leave before recording attendance that results in payments to employees.

DEPARTMENT OF INDUSTRIAL RELATIONS

Item 1. Monies Not Remitted Promptly to the General Fund

Finding: During fiscal year 1982-83, the Unpaid Wage Fund had not remitted monies to the General Fund that, by statute, belonged in the General Fund. We noted that as of July 1, 1982, the amount had exceeded the statutory limit of \$200,000; at May 31, 1983, the amount in excess of \$200,000 had accumulated to \$3,800,000. By not transferring these monies, the department has denied the General Fund use of these funds to pay current obligations.

Criteria: Labor Code Section 96.7 states that whenever the balance in the Industrial Relations Unpaid Wage Fund exceeds \$200,000, the Labor Commissioner shall transmit the excess amount to the General Fund.

Recommendation: The department should establish procedures to ensure the funds are remitted to the General Fund promptly when accumulated amounts exceed \$200,000.

Item 2. Inadequate Separation of Duties Pertaining to Payroll Transactions

Finding: Employees who certify attendance and process other personnel and payroll documents also receive and distribute salary warrants for the department's approximately 2,300 employees. Unless these duties are separated, an employee could authorize a fictitious payment for personal use.

Criteria: State Administrative Manual Section 8580.1 requires that persons who receive salary warrants, distribute salary warrants to employees, or handle warrants for any other purpose should not be authorized to process or sign personnel and payroll documents.

Recommendation: The department should assign the duties of distributing salary warrants to employees other than those who certify or process payroll and personnel documents.

Item 3.

Improper Separation of Duties Pertaining to Contract Approvals

Finding: The procurement supervisor has the authority to both initiate and approve contracts on behalf of the department. This lack of separation of duties increases the risk that contracts may be entered into under terms unfavorable to the State or for personal gain of an employee.

Criteria: Good internal control practices require that the authority to initiate and to approve contracts be assigned to two different individuals.

Recommendation: The department should not allow the procurement supervisor to approve contracts that he initiates.

DEPARTMENT OF JUSTICE

The Department of Justice administers one of the 49 federal grants we reviewed. It is the U.S. Department of Health and Human Services grant, Federal Catalog Number 13.775.

Item 1. Overcharges of Indirect Costs

Finding: The department overcharged the Medi-Cal Fraud Grant by \$16,236. The overcharge resulted because the department used an incorrect direct cost base to calculate indirect cost charges. After we informed department personnel of the error, they corrected the overcharge by reducing the billings to the federal government in March 1983.

Criteria: Federal Publication OASC-10 requires that recipients of federal funds should not charge indirect costs in excess of amounts approved in the Indirect Cost Plan.

Recommendation: The department should establish procedures that will assure that only indirect costs approved in the Indirect Cost Plan are charged to federal programs.

Item 2. Unbilled Rental Costs

Finding: The department did not recover all reimbursable costs associated with the Medi-Cal Fraud Grant. The department did not charge rental expenses for October and November 1983, totaling \$8,773, to the grant because of a coding error.

We informed department personnel of the coding error. The department subsequently charged the grant for the unbilled rental expenses in March 1983.

Criteria: State Administrative Manual Section 8755 requires state agencies to charge for all appropriate costs.

Recommendation: The department should establish procedures that will ensure that all reimbursable costs are billed to the federal government.

DEPARTMENT OF MENTAL HEALTH

Item 1. Incorrect Preparation of Financial Reports

Finding: The Department of Mental Health did not submit to the control agencies correct and complete year-end financial reports in accordance with the State Administrative Manual. We found that for fiscal year 1982-83 the department did not report correct amounts of revenues and expenditures in its financial reports and did not prepare the following required reports: (1) Report 15, "Reconciliation of Agency Accounts With Transactions Per State Controller"; (2) Report 9, "Analysis of Change in Fund Balance (Statement of Operations)"; and (3) Report 19, "Fixed Assets Certification." Additionally, the department records did not adequately support \$14.9 million in revenues and at the conclusion of our field audit work, December 29, 1983, the department was still in the process of trying to identify and support approximately \$10.4 million in expenditures.

Because of these deficiencies, the department's financial statements are neither complete nor accurate, and information reported to the State Controller is misstated.

Criteria: State Administrative Manual Section 7960 requires agencies to prepare complete year-end financial reports.

Recommendation: The department should prepare all required year-end financial statements in accordance with the State Administrative Manual.

Item 2. Late Financial Statements

Finding: The department did not submit its final financial statements to the State Controller until the middle of November 1983. The State Administrative Manual requires state agencies to submit their financial statements for governmental funds by July 20 and for nongovernmental funds by August 20. However, until the end of December, the department was correcting errors it had made during the year in entering data into the CALSTARS.

Agencies that submit financial statements late delay the State Controller in compiling complete financial statements for the State of California.

Criteria: State Administrative Manual Section 7950 requires agencies to submit their final financial statements no later than July 20 of each year for Governmental Funds and August 20 for Nongovernmental Funds.

Recommendation: The department should submit its financial statements to the State Controller by the dates required by the State Administrative Manual.

Item 3. **Inadequate Separation of Payroll Duties**

Finding: Atascadero State Hospital employees who certify and process personnel documents also distribute salary warrants. Unless these duties are separated, an employee could authorize a fictitious payment for personal use.

Criteria: State Administrative Manual Section 8580.1 requires that persons who receive, distribute, or handle salary warrants for any other purpose, should not be authorized to process or sign personnel documents.

Recommendation: The administrator of the hospital should assign the distribution of salary warrants to employees other than those who certify or process personnel documents.

Item 4. **Inadequate Separation of Accounting Duties**

Finding: Two employees in the accounting section of the hospital perform duties that are not adequately separated. One employee receives remittances, prepares deposits, prepares checks, and maintains the disbursement register. The second employee reconciles the bank account, controls the blank checks, maintains the receivable ledgers and general ledger, and also operates the computer terminals. Failure to separate these duties makes it possible for an employee to conceal irregularities and make unauthorized payments.

Criteria: State Administrative Manual Sections 8080 through 8080.2 prescribe the separation of duties for agencies whose accounting systems include manual and automated data processing. Section 8080.1 of the manual also prescribes that employees of units other than the accounting unit may be used to provide separation of duties.

Recommendation: The administrator of the hospital should reassign duties among employees in the accounting unit and other units of the hospital to provide the separation of duties as required by the State Administrative Manual.

DEPARTMENT OF MOTOR VEHICLES

Item 1.

Inadequate Monitoring of Internal Controls

- Finding: The department has not established an effective internal auditing function to monitor internal controls. Although the department annually collects approximately \$1.9 billion and spends over \$200 million, the Internal Audits Unit is not providing management with an effective measurement and evaluation of established systems of internal controls. As a result, management is not given timely assurance that the department is in compliance with the various policies, plans, procedures, laws, and regulations that have an impact on its operations and reports.
- Criteria: Government Code Section 1236 requires that internal auditors follow the general and specific standards established by the Institute of Internal Auditors, Inc. This body describes internal auditing as a managerial control that functions by measuring and evaluating the effectiveness of other controls.
- Recommendation: The department should require that the Internal Audit Unit monitor established systems of internal control on a continual basis.

Item 2.

Inadequate Preparation of Financial Statements

- Finding: The department's financial statements and supporting financial records contain numerous errors and inconsistencies, and the adjustments to the financial records are not supported by journal entries and/or other adequate documentation. As a result, the department did not submit its amended final year-end financial statements to the State Controller until nearly three months after the required submission date.
- Criteria: State Administrative Manual Section 7950 requires departments to submit accurate year-end financial statements to the State Controller no later than July 20 for Governmental Cost Funds.
- Recommendation: The department should implement procedures that ensure the adequate maintenance of financial records and the accurate and timely preparation of year-end financial statements.

Item 3. **Failure To Retain Records**

Finding: Because of limited storage space, the department does not maintain certain records that are necessary to verify the propriety of revenue transactions. These records include sundry revenue receipts, certificates of nonoperation, and International Registration Program transmittal notices.

Criteria: An adequate audit trail is necessary to enable management to direct and control its operations, to reconstruct files in the event of processing errors, and to accommodate the needs of internal and external auditors.

Recommendation: The department should retain records that support the propriety of all financial accounting transactions to meet the needs of the internal and external auditors and provide for its own protection.

Item 4. **Inadequate Monitoring of Sundry Revenue Transactions**

Finding: The department does not adequately monitor sundry revenue transactions. These transactions reflect the collection of drivers license fees and miscellaneous revenues. Although the department annually collects over \$80 million in sundry revenue, the Cash Audits Unit no longer reviews these activities. Without this review, the department has little assurance that these transactions are properly processed.

Criteria: Good internal control requires that sundry revenue transactions be monitored at headquarters to provide management with greater assurance that these transactions are properly processed by the field offices.

Recommendation: The department should implement procedures within the Cash Audits Unit to monitor sundry revenue transactions.

Item 5. **Inadequate Control over Accountable Items**

Finding: Under the department's present inventory system, there is no independent review of the inventory of accountable items and no report or standard against which to measure the inventory. The inventory of accountable items includes drivers license applications, registration stickers, suspense receipts, and license plates. Without adequate control over these items, there is a potential that undetected waste or misuse could occur.

Criteria: Good internal control requires an inventory system that provides a continuous record of accountable items received, issued, and on hand.

Recommendation: The department should implement an inventory system that will provide for control over the inventory of accountable items.

Item 6. **Inadequate Support for Uncleared Collections**

Finding: The June 30, 1983, uncleared collections account balance totaled approximately \$112 million. The department was unable to provide a detailed listing of uncleared collections that supported the account balance. Therefore, we could not verify the uncleared collections account balance by testing the transactions that support the total.

Criteria: Good internal control requires the periodic reconciliation of subsidiary records with the associated control account, thus assuring the detection of errors and the fair statement of the account balance.

Recommendation: The department should prepare a detailed listing of its uncleared collections and reconcile it to the account balance total.

DEPARTMENT OF PARKS AND RECREATION

The Department of Parks and Recreation administers one of the 49 federal grants we reviewed. It is the U.S. Department of Interior grant, Federal Catalog Number 15.916.

Item 1. Delays in Requesting Federal Reimbursements

Finding: The department did not promptly request reimbursements from the federal government under the State Planning Project Grant 060901. The department had not prepared the documents needed for requesting reimbursements, such as expenditure reports, planning narratives, and the audit report, until 17 months after the project was completed. We estimate that if the department had requested federal reimbursements promptly, interest earnings of the General Fund could have increased by approximately \$48,000. This estimate is based on a prevailing average interest rate at the time of 12 percent.

Criteria: State Administrative Manual Section 8755 requires state agencies to bill promptly for services provided to maximize the State's interest earnings.

Recommendation: The department should promptly prepare documents necessary to bill for services provided as required by the State Administrative Manual.

Item 2. Undocumented Distribution of Travel Expenses

Finding: During our examination of the Land and Water Conservation Fund Grant, we found that the department has not established an allocation system to equitably charge travel expenses to the appropriate funding sources. As a result, the department was unable to provide support for its distribution of actual travel expenses to individual projects.

Criteria: Federal Management Circular A-87 requires recipients of federal funds to establish an allocation system that identifies and equitably charges expenditures to the appropriate funding sources.

Recommendation: The department should comply with federal regulations and establish a system that identifies and equitably charges expenditures to the appropriate funding sources.

Item 3. **Travel Expense Claims Are Not Always Supported by Receipts or Vouchers**

Finding: We found that the department's travel expense claims are not always supported by airline ticket order stubs, unused portion of tickets, or other credit documents supporting reimbursements to employees. The failure to require receipts or vouchers for travel expense claims may result in erroneous or duplicate payments to employees.

Criteria: Board of Control Rule Sections 710(a) and 713(c) require that, with a few exceptions, receipts or vouchers be submitted for every item of expense.

Recommendation: The department should comply with Board of Control Rule Sections 710(a) and 713(c) by requiring receipts or vouchers for all items of expense claimed for reimbursement.

Item 4. **Inadequate Preparation of Financial Statements**

Finding: The department does not prepare its year-end financial reports in accordance with the State Administrative Manual. Specifically, for the General Fund, the department understated general cash at June 30, 1983, by \$48,265. Also, the department did not accrue a valid obligation for unpaid unemployment insurance compensation in the amount of \$499,688. In addition, for the State Beach, Parks, Recreation and Historical Facilities Fund of 1974 and the State Urban and Coastal Park Fund, the department did not segregate encumbrances outstanding from accounts payable at June 30, 1983. For the Parklands Fund of 1980, the department did not accrue all sub-purchase orders for goods or services received by June 30, 1983. Because of these deficiencies, the department's year-end financial reports are neither complete nor accurate when submitted to the State Controller.

Criteria: State Administrative Manual Section 7960 requires year-end financial reports to be submitted to the State Controller's Office with a certification that such statements are true and correct.

Recommendation: To make its year-end financial reports complete and accurate, the Department of Parks and Recreation should report all general cash, accrue all valid obligations, and separate encumbrances outstanding from accounts payable at June 30.

Item 5.

Inadequate Separation of Duties

Finding: A department employee who receives remittances, authorizes disbursements, and reviews and approves the bank reconciliation, also has custody of blank warrant stock. Failure to separate these duties makes it possible for one employee to make and conceal fictitious payments by preparing warrants for unauthorized disbursements, signing or forging signatures on the warrants, and concealing unauthorized disbursements in the bank reconciliations.

Criteria: State Administrative Manual Section 8080 specifies that the duties listed above should be separated and assigned to several employees.

Recommendation: The department should separate the duties of receiving remittances, authorizing disbursements, approving bank reconciliations, and having custody of blank warrant stock so that no one person performs more than one of these duties.

Item 6.

Unrecorded Cash Collections

Finding: Area offices do not submit deposit slips and reports of collections to department headquarters promptly because the department does not monitor the deposits and reports of area offices. As a result, the department's control over cash collections and deposits is weak and the department's cash account is continually understated. As of June 30, 1983, the department's cash account was understated by approximately \$1.7 million.

Criteria: To provide accounting control and to ensure that the department's year-end financial reports are correct, the department's cash account must be promptly credited for all cash collections.

Recommendation: The department should instruct area offices to submit deposit slips and reports of collections to department headquarters promptly. In addition, the department should monitor the area offices to ensure that these instructions are followed.

Item 7.

Inadequate Control over Salary Advances

Finding: At June 30, 1983, the department's salary advances outstanding over six months totaled approximately \$18,000. These advances, which are interest free

loans, made up more than half of the department's total salary advances at June 30, 1983. The long outstanding advances result from a lack of effort to collect amounts due from employees.

Criteria: State Administrative Manual Sections 8118 and 8595 specify that salary advances should be cleared during the next pay period when the department receives the State Controller's warrant. In addition, Section 8580.4 states that agencies are not to distribute salary warrants to terminating or transferring employees until the agency is assured that all previous outstanding advances have been cleared.

Recommendation: The department should establish procedures to ensure compliance with State Administrative Manual requirements regarding salary advances. In addition, the department should establish schedules to recover the salary advances or seek relief of accountability from the State Board of Control.

Item 8.

Checks Outstanding over Two Years

Finding: The department has checks outstanding over two years totaling \$4,469. These checks must be considered each month when a bank reconciliation is prepared. This is unnecessarily cumbersome and time consuming and serves no useful purpose.

Criteria State Administrative Manual Section 8042 requires that checks outstanding over two years be cancelled and the amount of such checks be remitted to the Special Deposit Fund as unclaimed moneys.

Recommendation: The department should comply with Section 8042 of the State Administrative Manual.

Item 9.

Improper Accounting for Receivables

Finding: The department's receivable balance is overstated and does not accurately reflect the amounts owed the department. The department does not reduce receivable balances for partial collections; instead, the department holds the partial collections as uncleared collections until the entire balance is collected. The collections are then recorded in the Accounts Receivable ledger and transferred to a fund in the State Treasury accounted for by the State Controller.

Criteria: Good accounting control for receivables requires accurate and timely recordkeeping in order to reflect the true amounts owed the department. In addition, State Administrative Manual Section 8091 requires departments to remit collections to a fund in the State Treasury within 30 days of the date of collection.

Recommendation: The department should reduce receivable balances as collections are made and remit these collections to a fund in the State Treasury as required by the State Administrative Manual.

Item 10. **Lack of Control over Revolving Fund Accounts**

Finding: The department does not use a revolving fund receivable ledger; as a result, we were unable to obtain adequate documentation to support the revolving fund balances.

Criteria: State Administrative Manual Section 8190 directs state agencies to use a receivable ledger to account for revolving fund transactions.

Recommendation: The department should establish and maintain a revolving fund receivable ledger as required by the State Administrative Manual.

DEPARTMENT OF REHABILITATION

The Department of Rehabilitation administers one of the 49 federal grants we reviewed. It is the U.S. Department of Education grant, Federal Catalog Number 84.126.

Item 1: Lack of Written Procedures

Finding: The department has not established written procedures for preparing federal financial reports and requesting federal funds. As a result, the department made several errors in preparing the worksheets used to support the financial status report of the Basic Support, Section 110, grant for the quarter ended June 30, 1983. The net effect of the errors was to understate expenditures by \$20,928. The Department of Finance reported the lack of written procedures in its two Office of Management and Budget Circular A-102, Attachment P, audit reports dated December 31, 1981, and January 3, 1984. However, the department has not yet taken corrective action.

Criteria: Good management practices require written procedures for significant aspects of agency accounting. The procedures should ensure that the federal financial reports are accurate, and are in conformance with federal rules and regulations.

Recommendation: The department should prepare written procedures for preparing federal reports and drawing federal funds.

DEPARTMENT OF SOCIAL SERVICES

The Department of Social Services administers 7 of the 49 federal grants we reviewed. They are the U.S. Department of Health and Human Services grants, Federal Catalog Numbers 13.802, 13.808, 13.814, 13.646, 13.667, 13.679; and U.S. Department of Agriculture grant, Federal Catalog Number 10.551.

Item 1. Payments to Counties Could Exceed Authorized Limits

Finding: The department did not reconcile county Cost Allocation Plans (CAP) approved by the State Controller's office with county claims for fiscal year 1982-83. As a result, the department could pay claims for administrative costs from counties in excess of the amounts approved in their respective CAPs. The department has proposed a process that will allow it to reconcile the fiscal year 1983-84 claims to the respective CAPs.

Criteria: To assure that all claimed costs have been approved and that claimed costs do not exceed amounts approved in county CAPs, county claims must be reconciled to approved CAPs.

Recommendation: Prior to approving payments to counties for administrative costs, the department should reconcile approved county CAPs with county claims to ensure that claimed costs do not exceed costs approved by the State Controller.

Item 2. Delays in Requesting Federal Reimbursement

Finding: The department is losing potential interest earnings due to delays in requesting federal reimbursement. Lost interest earnings on delayed reimbursements approximated \$121,000 for fiscal year 1982-83. The department did not promptly request federal reimbursement under various federal programs because interagency agreements with the State Department of Health Services were not signed in a timely manner.

In estimating the additional interest that the State could have earned, we based our calculations on the prevailing interest rate of approximately 10.5 percent for fiscal year 1982-83. In previous reports, we noted losses to the department for fiscal years 1980-81 and 1981-82 totaling \$311,500. Some,

but not all, of the fiscal year 1983-84 interagency agreements with the Department of Health Services have been signed in a reasonably timely manner.

Criteria: Prudent fiscal management requires that interagency agreements be executed promptly so that the State can collect all reimbursements due from the federal government as soon as the State is entitled.

Recommendation: The department should ensure that all interagency agreements that relate to federal reimbursement are executed in a timely manner.

Item 3. **Federal Financial Reports Are Not Reconciled to the Accounting Records**

Finding: The department did not reconcile its federal financial reports with departmental accounting records for fiscal year 1982-83. Failure to reconcile federal financial reports to the accounting records can result in the misstatement of claims for cash advances and reimbursements from the federal government and may also prevent the early detection of irregularities such as erroneous adjustments and nonreceipt of federal funds. The Department of Finance prepared reconciliations of the department's federal financial reports for three programs as of September 30, 1982.

Criteria: Department of Finance management memo 83-21 requires all state agencies receiving federal funds to direct their accounting officer to reconcile federal financial reports to their official accounting records.

Recommendation: The department should direct its accounting officer to reconcile federal financial reports to its official accounting records.

Item 4. **Inadequate Time Distribution Records**

Finding: We found that the department's Employment Programs Bureau did not maintain appropriate time distribution records to demonstrate that employee time was distributed equitably among the various federal programs. Failure to maintain time distribution records may result in the loss of federal funds. The department has proposed procedures to maintain time distribution records for the 1983-84 fiscal year.

Criteria: Federal Management Circular 74-4 Attachment B requires that salaries and wages of employees chargeable to more than one grant program or other cost objective be supported by appropriate time distribution records.

Recommendation: The department should implement its proposed procedures to maintain appropriate time distribution records for employees whose time is chargeable to more than one grant program.

Item 5. **Excessive Federal Funds On Hand**

Finding: We found that at times the department requests federal funds three months in excess of cash needs. As an example, in one transaction, approximately \$3,514,248 was on hand three months before disbursement. Maintaining "excessive cash" may result in the termination of advance financing from the federal government.

Criteria: Department of Treasury Circular 1075 Section 205.4 requires that "the timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization."

Recommendation: The department should immediately implement cash management procedures to ensure that federal cash is not drawn in excess of that required for immediate disbursement needs.

Item 6. **Failure To Require Authorized Notices of Employee Leave Taken**

Finding: The department does not have adequate procedures to ensure the accuracy of attendance reports. When attendance reports submitted by various departmental units to the Personnel Bureau fail to include an authorized notice of leave taken, the Personnel Bureau prepared a "dummy" notice indicating leave reported on the attendance report. The Bureau maintains the "dummy" in the file until the authorized notice is received; however, the authorized notice may be received excessively late or not at all. Without properly authorized notices of leave taken, the appropriateness of payroll expenditures is in doubt.

Criteria: The accuracy of the attendance reports, upon which payroll amounts are based, requires that the notice of leave taken be submitted promptly.

Recommendation: The department's Personnel Bureau should establish a procedure to obtain the authorized notices within a reasonable period of time, guaranteeing that the "dummy" notices are only temporary substitutes.

Item 7. **Payment of Airline and Car Rental Billings without Evidence of Unit Approval or Receipt**

Finding: The department permits invoices for airline travel and car rental to be paid without evidence of approval from unit supervisors and without evidence of actual use of the services. The propriety of the billings is checked against information on travel claims subsequently submitted. However, payment before receipt of authorization may result in inappropriate payments.

Criteria: Proper internal control requires that the accounting unit have documented evidence that expenditures are justified and approved before any invoices are paid.

Recommendation: The department should require units responsible for the expenditures to send to the accounting unit timely notices of approved airline and car rental expenditures and of actual use of the services, against which the accounting unit can check billings before they are paid.

Item 8. **Failure To Require Completed Checkout Procedures for Terminating Employees**

Finding: Employees have been allowed to leave department employment without having a completed and authorized checkout list on file. Proper checkout procedures prevent employees from terminating employment with the State or transferring to another state agency without clearing outstanding advances. Proper procedures also assure the return of state property such as credit cards and keys.

Criteria: State Administrative Manual Section 8580.4 requires that salary warrants "not be distributed to a terminating employee until the agency is assured that all outstanding travel and salary advances have been paid." The checkout list is used to document this procedure.

Recommendation: The department should not issue employees their separation warrants until the checkout list is on file. The supervisory review should include determination of the presence of the completed and authorized checkout document.

Item 9. **Incorrect Lump Sum Payments to Separating Employees**

Finding: Department procedures for determining lump sum payments to separating employees should be improved. We found that seven separating employees had received incorrect amounts; five were underpaid a total of \$1,033.62 and two were overpaid a total of \$2,705.38.

Criteria: Prudent fiscal management requires that procedures be adequate to assure that separating employees receive the correct amount due.

Recommendation: The Personnel Bureau should require employees computing separation amounts to prepare worksheets showing the computation of leave amounts due. The worksheets should take into account leave used during the month of separation. The personnel supervisor should review the worksheets for completeness and accuracy.

Item 10. **The Department Is Behind in Preparation of a Reconciliation of Estimates to Actual Amounts**

Finding: The department has not reconciled its estimated county collections with the actual county collections from absent parents for the Child Support Enforcement Program in more than one year. As a result, for the quarter ending March 1982, the department owes various counties approximately \$408,577.

Criteria: Good internal control requires procedures to periodically adjust estimated collections to actual amounts collected.

Recommendation: The department should prepare quarterly reconciliations between estimated county collections and actual county collections from absent parents for the Child Support Enforcement Program.

OFFICE OF THE STATE CONTROLLER

The Office of the State Controller administers one of the 49 federal grants we reviewed. It is the U.S. Department of Treasury grant, Federal Catalog Number 98.005.

Item 1. Inadequate Control over Accounts Receivable

Finding: The State Controller's office does not promptly record audit exception transactions in the general ledger. Because of this deficiency, the Accounts Receivable-Audit Exceptions account balance is neither complete nor accurate.

Criteria: Good internal control requires that transactions be recorded promptly to ensure the completeness and accuracy of the accounting records.

Recommendation: The State Controller's office should implement procedures to record all transactions affecting Accounts Receivable-Audit Exceptions promptly.

Item 2. Inadequate Review of Interest Calculations

Finding: The Investments Unit calculates the distribution of interest earnings, but it does not provide for a review of the calculations by someone other than the employee performing the calculations. As a result, errors have occurred. For example, at June 30, 1983, we determined that the interest calculated for distribution to the General Fund was \$54,000 less than the fund was entitled to receive. As a result, the interest calculated for distribution to the Fish and Game Wildlife Preservation Fund, the Surplus Money Investment Fund, and the Local Agency Investment Fund was greater than these funds were entitled to receive by \$42,700, \$7,900, and \$3,400, respectively.

The State Controller's office initially allocated the interest to the respective funds in June 1983 but subsequently corrected the erroneous allocation in November 1983.

Criteria: Good internal control requires that procedures be implemented that provide an opportunity to detect and correct errors in calculations.

Recommendation: The State Controller's office should implement procedures to provide a review of the accuracy of the interest calculations by someone other than the employee performing the calculations.

Item 3. **Inadequate Review of School Unit Accounting Transactions**

Finding: The School Unit has not established procedures to ensure that the accounting records accurately reflect transactions. We found posting errors in the Due from School Districts-Loans account in the State School Building Aid Fund. These errors result from the lack of a review by someone other than the employee who posted the transactions.

Criteria: Good internal control requires that procedures be implemented that provide an opportunity to detect and correct posting errors.

Recommendation: The State Controller's office should implement procedures to provide a review of the accuracy of the postings to the Due from School Districts-Loans account.

OFFICE OF THE STATE TREASURER

Item 1. **Market Value of Securities Not Estimated**

Finding: The State Treasurer did not determine the estimated value of Federal Home Loan Mortgage and Government National Mortgage Association securities constituting 11 percent of the Pooled Money Investment Account as of June 30, 1983. Failure to determine the market value of these securities means that the State's financial statements do not disclose accurate, current data.

Criteria: Preferred Accounting Practices for State Governments, published in 1983 by the National Council on Governmental Accounting, states that temporary investments should be reported at cost and that the market value of the investments should be disclosed.

Recommendation: To properly disclose the market value of the Pooled Money Investment Account, the State Treasurer should determine, or have an appraiser determine, the market value of Pooled Money Investment Account securities on June 30 of each year. In particular, the State Treasurer should establish the value of those classifications of securities whose term to maturity is more than one year. Such securities include Federal Home Loan Mortgage and Government National Mortgage Association securities.

Item 2. **Late Bank Reconciliations**

Finding: As of October 11, 1983, the State Treasurer had not reconciled its agency checking account for the month ended July 31, 1983. Failure to reconcile agency checking accounts promptly can result in the misstatement of cash balances and may prevent the detection of unauthorized disbursements or undeposited monies.

Criteria: State Administrative Manual Section 8060 requires agencies to reconcile agency checking accounts promptly at the end of each month.

Recommendation: The State Treasurer should reconcile its agency checking account promptly at the end of each month.

Item 3.

**Custody of Securities Is Not Adequately Separated
from the Accountability for Securities**

Finding: Employees who maintain the accounting records for securities in the State Treasurer's vault frequently enter the vault to obtain certificate numbers for vault release documents. Employees having access to both the securities in the vault and the accounting records may be able to conceal missing securities without being detected.

Criteria: Good internal control recommends that the custody of securities be kept separate from the accountability for securities.

Recommendation: The State Treasurer should prohibit access to the vault for employees who maintain the accounting records of securities.

STATE WATER RESOURCES CONTROL BOARD

The State Water Resources Control Board administers 3 of the 49 federal grants we reviewed. They are the U.S. Environmental Protection Agency grants, Federal Catalog Numbers 66.419, 66.426, and 66.438.

Item 1.

Late Federal Financial Reports

Finding:

The SWRCB did not submit required federal financial reports promptly. The SWRCB did not submit quarterly reports of Federal Cash Transactions for the period of July 1, 1981, to December 31, 1982, until February 24, 1983. Furthermore, the SWRCB's annual Financial Status Reports submitted for the fiscal year ended September 30, 1982, were four to six months late.

Failure to comply with these reporting requirements may result in revocation of the SWRCB's letter of credit with the Environmental Protection Agency and the financing method being changed to a reimbursable basis.

Criteria:

Chapter 5 of the Environmental Protection Agency's Letter of Credit Users Manual requires that Reports of Federal Cash Transactions be submitted within 15 working days after the end of each calendar quarter. The manual also requires that Financial Status Reports be submitted within 30 days after the end of the fiscal year and a final report within 90 days after the end of the grant period or completion of the project.

Recommendation:

The SWRCB should file all federal financial reports by the dates they are due.

Item 2.

Inadequate Reporting of Time

Finding:

The SWRCB did not obtain the required signatures and approvals on employees' time sheets. We noted 13 instances in which employees did not sign their time sheets. We also noted 44 instances in which designated employees did not review and approve the time sheets of managerial or executive level employees. Unless time sheets are signed and approved, the accuracy and propriety of the hours worked and the hours charged to the various federal projects are questionable.

Criteria: Federal Management Circular 74-4, Section 106, states that amounts charged to grant programs for personal services, regardless of whether treated as direct or indirect, will be based upon payrolls that have been documented and approved.

Recommendation: The SWRCB should require all employees to verify and sign their own time sheets and require supervising or designated employees to review and approve all time sheets.

DEPARTMENT OF TRANSPORTATION

The Department of Transportation administers 2 of the 49 federal grants we reviewed. They are the U.S. Department of Transportation grants, Federal Catalog Numbers 20.205 and 20.500.

Item 1. Incorrect Recording of Cash

Finding: The department's June 30, 1983, balance of cash is understated by \$660,901 because the department did not record undeposited state warrants representing reimbursements of revolving fund payments.

Criteria: State Administrative Manual Section 10405 requires agencies to record all state warrants on hand at the end of the year in the cash on hand in agency account.

Recommendation: The department should record all undeposited warrants on hand at the end of the fiscal year in the cash on hand in agency account.

Item 2. Cash Receipt Dates Not Identified

Finding: The department does not maintain a record of dates on which it receives cash. Failing to record the date that cash is received makes it difficult to determine the fiscal year in which to record cash receipts and makes it difficult to determine the timeliness of deposits.

Criteria: State Administrative Manual Section 8093 states that agencies should note the cash receipt date on the cash report.

Recommendation: The department should establish cash control procedures to record cash receipt dates.

Item 3. Lack of Control and Accountability over Revolving Fund and Cash Suspense Accounts

Finding: The department's San Francisco district has inadequate accountability and control over revolving fund and cash suspense accounts. We found four specific weaknesses. First, the person with access to the blank check stock also has access to the check-signing machine. Second, the district cashier

issues travel advances to employees without a signed travel advance request form and clears items from the cash suspense account without appropriate authorization. Third, accounting personnel are not promptly reconciling revolving fund and cash suspense account balances to the detail of subsidiary ledgers at the end of the month. Finally, the district was unable to locate several months' worth of check registers and other detail records for the revolving fund and cash suspense accounts related to our audit period.

Criteria: State Administrative Manual Section 8080 states that a person who has access to the blank check stock should not operate a check-signing machine. Under good internal control procedures, disbursements should be supported by appropriate documentation, cash accounts should be promptly reconciled to subsidiary records, and accounting records should be adequately safeguarded.

Recommendation: The department's San Francisco district should maintain accountability for cash in accordance with the State Administrative Manual and good internal accounting control procedures.

Item 4. **Improper Accounting Procedures for Accounts Receivable and Revenue**

Finding: The accounts receivable of the department's San Francisco and Los Angeles districts included \$4,234,198 in revenue for unfinished sales of excess lands. These sales either have not entered or have not completed escrow proceedings. Until sales of excess lands complete escrow proceedings, no debtor liability to the department exists; therefore, it is improper for the department to record a receivable.

Criteria: Under generally accepted accounting principles, income is not accrued unless a debtor's liability has been clearly established.

Recommendation: The department should not record receivables for sales of excess lands or show revenue for such receivables until escrow proceedings close.

Item 5. **Inadequate Collection Procedures**

Finding: The department's San Francisco and Los Angeles districts have not established adequate collection programs for delinquent accounts receivable on

installment sales of excess lands. As a result, approximately \$1.6 million in receivables at June 30, 1983, were delinquent for more than nine months. For two of these delinquent accounts, the department has not received payments since 1979.

Criteria: State Administrative Manual Section 8776.5 requires agencies to develop adequate procedures for collecting overdue accounts receivable, and Chapter 9, Section 6.7, of the department's accounting manual requires prompt collection efforts for delinquent accounts receivable.

Recommendation: The department should establish collection procedures and promptly collect receivables on installment sales of excess lands. These collection procedures should include foreclosures when appropriate.

Item 6.

Delayed Billing for Federal Reimbursement

Finding: The department has delayed billing the federal government for utility relocation costs that are eligible for reimbursement. As of June 30, 1983, we identified \$452,807 in utility relocation costs for which the department had not sought reimbursement. These costs had been eligible for reimbursement for two to six years. The department had not billed the federal government because accounting personnel failed to clear the costs from a billing suspense field once they became eligible for federal reimbursement. (The billing suspense field designates costs that are not yet eligible for federal reimbursement or costs for which eligibility for federal reimbursement has not yet been determined.) Costs that had not been cleared from the billing suspense field as of June 30, 1983, included federally reimbursable progress payments to utility companies and federally reimbursable final payments to utility companies.

Criteria: Chapter 15, Section 6.3.1, of the department's accounting manual states that after the Federal Highway Administration approves a utility agreement, progress payments to the utility company should be coded for federal reimbursement. Chapter 15, Section 6.3.2, of the department's accounting manual specifies that final payments to a utility company for federally reimbursable utility relocation costs should be coded to the billing suspense field until the work has been audited. Once the work has been audited and the utility company has been paid, final utility bills should be promptly billed to the federal government.

Recommendation: The department should improve its procedures for collecting amounts owed to the State by the federal government for utility relocation costs. The department should also monitor and eventually clear all entries made to the billing suspense field.

Item 7. **Incorrect Accounting for Collections of Revenue Receivables**

Finding: The department does not properly account for receipts that were earned in previous fiscal years. The department maintains receivable records to account for purchases and rentals of state properties by individuals and governments. However, as receivables are liquidated, the department has no means of reporting which collections apply to income that was earned for the preceding fiscal year. As a result, current revenues of the State Highway Account may be misstated.

Criteria: State Administrative Manual Section 10478 requires state agencies to use the prior-year income adjustment account to reflect the difference between the amount of income accrued as of the previous June 30 and the amount of income actually received with respect to the items accrued. Proper use of the prior-year income adjustment account strengthens the control over revenue accounting and provides management with more accurate data with which to assess its accounts receivable collection efforts.

Recommendation: The department should develop procedures to identify the period in which receipts for accounts receivable were earned and to account for these receipts properly.

Item 8. **Incorrect Accounting for Rental Revenue**

Finding: In the State Highway Account, receivables that are due from rentals of property and that are estimated to be collected within one year were not shown as revenues for the current year.

Criteria: Under generally accepted accounting principles and under State Administrative Manual Section 10591, revenue should be accrued when it is measured and determined to be collectible within one year. Failure to accrue revenues in the proper year distorts the department's financial statements.

Recommendation: The department should recognize as revenue all amounts that are estimated to be collected within one year.

Item 9. **Inadequate Internal Control over Accounting for Accounts Receivable**

Finding: We noted inadequate reconciliation and accounting procedures for accounts receivable in the department's Los Angeles district office. As of September 30, 1983, the Los Angeles district office had not reconciled the supporting detail of its accounts receivable system's balance to the general ledger control balance for June 30, 1983. We also noted uncollectible accounts receivable of \$648,783 that had been approved for cancellation by department headquarters but had not been removed from the accounting records at June 30, 1983. Additionally, the Los Angeles district office overstated accounts receivable for "work-for-others" projects by \$1.5 million. This occurred because the district office established receivables based on preliminary estimates of reimbursable project costs; however, when actual costs became known, the amount of receivables was not adjusted. Finally, we found that some interest receivables for installment sales of excess lands were understated by \$102,959, while others were overstated by \$68,790.

Criteria: Good internal accounting control requires that subsidiary receivable balances be reconciled to the general ledger control at the end of the year. Generally accepted accounting principles require that receivables reflect only net collectible amounts.

Recommendation: The department's Los Angeles district office should reconcile its subsidiary receivable balances to the general ledger control. Further, the district office should assure that its receivable balances reflect only valid amounts.

Item 10. **Inaccurate Identification of Obligations**

Finding: The department's accounting personnel did not accurately identify which of its unliquidated encumbrances constituted obligations at June 30, 1983. As a result, the department understated the obligations it reported to the State Controller by \$12.6 million.

Criteria: A State Controller's Memorandum issued on May 27, 1983, requires that agencies analyze unliquidated encumbrances to determine what portion is for encumbrances outstanding (goods or services not received as of June 30, 1983) and what portion is for obligations (goods or services received as of June 30, 1983). This differentiation is necessary to allow the State Controller to present financial statements in accordance with generally accepted accounting principles.

Recommendation: The department should accurately determine which of its unliquidated encumbrances are obligations at June 30.

Item 11. **Inadequate Accountability over Encumbrances**

Finding: The department inaccurately reported its support encumbrances balance, resulting in an overstatement of approximately \$3.8 million at June 30, 1983. This occurred because the department did not correctly code expenditure input documents; therefore, expenditures were either applied to the wrong encumbrance balance or were not applied to an encumbrance balance at all.

Criteria: State Administrative Manual Section 8340 requires expenditures recorded on claims to be posted to the various encumbrance documents affected, thereby reducing the amounts shown as unliquidated encumbrance.

Recommendation: The department should establish procedures that ensure that it accounts for encumbrances accurately.

Item 12. **Encumbrances for Construction Projects Are Not Liquidated Promptly**

Finding: The department is not promptly filing final reports of expenditures upon completion of its construction projects. The final report of expenditures summarizes the accounting transactions for construction projects and is the document used to revert unliquidated project encumbrances. As a result of not promptly filing final reports of expenditures, the department is failing to disencumber funds that otherwise might be used for new construction projects.

District accounting officers failed to submit final reports of expenditures within six months of the project completion date for 24 of 40 projects we reviewed in district offices. Of the 42 projects we examined at department headquarters, we found that the department did not complete final reports of expenditures within six months of project completion for 19 projects.

Criteria: Department policy requires the department to prepare final reports of expenditures within six months of project completion. State Administrative Manual Section 10584 states that agencies should liquidate unliquidated encumbrances that are not valid obligations of the year just ended.

Recommendation: The department should review project completion procedures and liquidate encumbrances when appropriate.

DEPARTMENT OF WATER RESOURCES

The Department of Water Resources administers one of the 49 federal grants we reviewed. It is the Federal Emergency Management Agency grant, Federal Catalog Number 83.100.

Item 1.

Encumbrances Improperly Recorded

Finding: The department improperly recorded the encumbrances outstanding at the end of the year as liabilities and as expenditures of fiscal year 1982-83, for the California Water Resources Development Bond Fund, the Central Valley Water Project Construction Fund, the Central Valley Water Project Revenue Fund, and the Water Resources Revolving Fund. This resulted in an overstatement of both expenditures and liabilities of approximately \$33 million in the year-end financial statements.

Criteria: State Administrative Manual Sections 12400 and 13400 direct state agencies to accrue expenditures in public service enterprise funds and revolving funds only on the basis of services received and goods used.

Recommendation: The department should only accrue expenditures for services received and goods used.

Item 2.

Intrafund Transactions Improperly Reported

Finding: The department records the value of power generated and used by the State Water Project as both an expenditure and revenue of the California Water Resources Development Bond Fund. This resulted in an overstatement of both expenditures and revenue of approximately \$7.5 million for fiscal year 1982-83.

Criteria: Proper accounting practice requires that expenditures and revenue be recognized only in those transactions involving outside parties.

Recommendation: The department should not recognize expenditures and revenue involving intrafund transactions.

Item 3.

Cash Receipts Not Recorded in Proper Period

Finding: The department enters cash receipts into the accounting records using the date of deposit rather than the date of receipt. As a result, approximately \$850,000 in undeposited receipts on hand at June 30, 1983, were not reported in the department's year-end financial statements.

Criteria: State Administrative Manual Section 7620 requires state agencies to report undeposited receipts as cash on hand.

Recommendation: The department should enter cash receipts into the accounting records when the cash is received.

Item 4.

Depreciation Expense Understated

Finding: The department incorrectly reduces depreciation expense by the amount of the accumulated depreciation on assets retired. This results in an understatement of depreciation expense. For fiscal year 1982-83, the department understated its depreciation expense by approximately \$280,000.

Criteria: Proper accounting practice requires that the amount reported as depreciation expense reflect only the depreciation charges for the current period.

Recommendation: The department should report depreciation expense for an amount reflecting current period charges.

Item 5.

Deposits Not Checked for Timeliness of Posting by the Bank

Finding: The department does not verify that deposits are posted promptly by the bank. For the period reviewed, we found that 41 deposits were posted one to five days after being presented to the bank. Based on the average interest rates for the Pooled Money Investment Account for the period reviewed, we estimate that the department lost approximately \$37,000 in interest earnings during fiscal year 1982-83 because the bank delayed posting deposits to the department's general checking account.

Criteria: To ensure that deposits are posted promptly, State Administrative Manual Section 8032 requires state agencies to verify that the posting date placed on the Report of Deposit corresponds to the date the deposit was presented to the bank.

Recommendation: The department should review all Reports of Deposit to ensure that deposits are being posted by the bank without unreasonable delay.

Item 6. **Uncollectible Amounts Reported As Receivables**

Finding: At June 30, 1983, the department reported a receivable in the Water Resources Revolving Fund for a \$93,794 reimbursement due from the General Fund. This receivable appears uncollectible, however, because the related appropriations in the General Fund have expired.

Criteria: State Administrative Manual Section 8776.2 defines a current receivable as a receivable that is expected to be collected within one year.

Recommendation: The department should report as "fully reserved" those receivables that it does not expect to collect within one year.

Item 7. **Bank Draft Account Balance Overstated**

Finding: The department maintains a bank draft account outside the State Treasury System so that outlying field sites may make purchases in small amounts. The department reported the bank statement balance for this account as \$29,286 at June 30, 1983. This balance, however, overstates the book balance by the amount of any outstanding checks.

Criteria: State Administrative Manual Section 7975 requires state agencies to report the book balance on the Report of Bank/Savings and Loan Accounts Outside the Treasury System.

Recommendation: The department should report the book balance for its bank draft account in its financial statements.

Item 8. **EDP System Access Controls Not Adequate**

Finding: The department has not adequately restricted access to its EDP system. Inadequate control over access could result in unauthorized changes to master data files or to applications program software.

Criteria: State Administrative Manual Section 4846.5 limits access to master data files and applications program software to properly authorized individuals. This protects the integrity of the data generated by the system.

Recommendation: The department should ensure the following: (1) that users attempting to gain access to the system through remote dial-up terminals are not permitted to redial for access if they fail to gain access initially; (2) that user passwords are not displayed on CRT screens during input; (3) that access to the validation file containing user passwords is restricted to only those individuals requiring such access; (4) that violation logs reporting unauthorized access attempts are reviewed regularly by management; (5) that formal procedures exist to ensure that changes to the operating system are reviewed and approved before they are implemented; (6) that formal procedures exist to ensure that users signify their approval of changes to application programs; (7) that only test data are used to test program changes; and (8) that jobs are scheduled to ensure that all jobs are run and that no jobs are run more than once.

Item 9. **General Ledger Accounts Not Reconciled to Subsidiary Accounts**

Finding: The department does not reconcile the general ledger control accounts used for property and accumulated depreciation to the underlying subsidiary accounts. As a result, amounts reported in the department's financial statements are not adequately supported.

Criteria: State Administrative Manual Section 8654.1 requires that the balance of each general ledger control account must agree with the sum of the balances of the corresponding subsidiary accounts.

Recommendation: The department should regularly reconcile all general ledger control accounts to the appropriate subsidiary accounts.

Item 10. **Documentation of Encumbrances Not Adequate**

Finding: The department does not maintain a detailed listing of encumbrances that are charged to more than one appropriation. As a result, amounts reported in the department's financial statements are not adequately supported.

Criteria: Proper internal accounting control requires that a detailed listing of such encumbrances be maintained to facilitate review of the underlying support.

Recommendation: The department should keep listings of encumbrances both by appropriation and by individual encumbrance.

**REPORT ON COMPLIANCE WITH
FEDERAL GRANT REQUIREMENTS**



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Members of the Joint Legislative Audit Committee
State of California

We have examined the General Purpose Financial Statements of the State of California for the year ended June 30, 1983, and have issued our report thereon dated December 22, 1983. Our examination was made in accordance with generally accepted auditing standards; the provisions contained in the U.S. Comptroller General's Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, as they pertain to financial and compliance audits; the provisions of the Office of Management and Budget (OMB) Circular A-102, Uniform Administrative Requirements for Grants-In-Aid to State and Local Governments, Attachment P, Audit Requirements: Guidelines for Financial and Compliance Audits of Federally Assisted Programs; and the December 7, 1982, revision of the Uniform Requirements for Grants to State and Local Governments (compliance supplement). Certain grant programs administered by the State of California were not included in the compliance supplement. For those programs, we reviewed the grant awards and applicable federal regulations to determine the major compliance requirements to be tested. Our examination included tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The scope of our examination did not extend to programs administered by the University of California. The University of California contracts with independent CPAs for a financial and OMB Circular A-110 audit. Results of the University's Circular A-110 audit are not included in this report. In addition, our examination of charges made by subrecipients of federal funds was limited to a review of the State's system for monitoring these subrecipients. Some subrecipients have Circular A-102 P audits performed by independent auditors. The major entities in California that have Circular A-102 P audits performed are local school districts and certain cities and counties.

In our opinion, except as discussed in the following paragraph, the State of California complied with the terms and conditions of its grant awards and applicable federal regulations for the transactions tested in all material respects. Further, nothing came to our attention that would indicate that the State did not comply with the terms and conditions of its grant agreements and applicable federal regulations in all material respects for the transactions not tested.

Members of the Joint Legislative Audit Committee
State of California

Our examination did reveal some instances of noncompliance with terms and conditions of grant awards and applicable federal regulations. We discuss the instances of noncompliance on pages 63 through 163 of our report. We also present recommendations to remedy the instances of noncompliance and management's comments regarding the recommendations.

A summary schedule of federal assistance for the year ended June 30, 1983, is included on page 171 of this report. The schedule of federal assistance shows the amount and type of federal funds received by the State of California for the year ended June 30, 1983; it also shows which grants we reviewed. In our opinion, the schedule of federal assistance is fairly stated in all material respects in relation to the General Purpose Financial Statements.

In addition to the work we performed for the Circular A-102 P audit, we performed other reviews related to federal programs. A schedule of the pertinent reports issued from July 1, 1982, through December 31, 1983, is included in Appendix B of this report.

OFFICE OF THE AUDITOR GENERAL



KARL W. DOLK, CPA
Assistant Auditor General

February 24, 1984

**STATE OF CALIFORNIA
SCHEDULE OF FEDERAL ASSISTANCE
FOR THE FISCAL YEAR ENDED JUNE 30, 1983**

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Judicial Council:		
Part F--Discretionary Grants	16.531	\$ 113,533
Secretary of Health and Welfare:		
Special Programs for the Aging-- Title IV Part C--Discretionary Projects and Programs	13.634 (13.668)*	67,708
Secretary of Resources:		
Other--U.S. Department of the Interior	15.999	64,000
Office for Citizen Initiative and Voluntary Action:		
State Office of Voluntary Citizen Participation	72.011	15,583

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Office of California/Mexico Affairs:		
Economic Development--State and Local Economic Developmental Planning	11.305	35,000
Office of Planning and Research:		
Comprehensive Planning Assistance	14.203	342,921
Solid Waste Disposal Research Grants	66.504	149,012
Toxic Substances Research Grants	66.507	1,894 A
Energy Extension Service	81.050	499,783
Office of Economic Opportunity:		
Low Income Home Energy Assistance Program	13.816 (13.818)*	97,681,951 A 0
Community Services Block Grant Emergency Energy Conservation Services	13.665 49.014	13,550,967 0 94,193
Weatherization Assistance for Low-Income Persons	81.042	3,298,359
Office of Emergency Services:		
Forestry Cooperative Research	10.651	24,297
Cooperative Forestry Assistance	10.664	96,197

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

0 - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Office of Emergency Services:		
Civil Defense--State and Local Maintenance and Services	12.319	(1,042,116)
Civil Defense--State and Local Supporting Materials	12.321	12,500
Disaster Assistance	14.701	730,289
Civil Defense--State and Local Management	83.200	3,923,746
Civil Defense--State and Local Maintenance and Services	83.201 (83.504)*	646,680
State Disaster Preparedness Grants	83.203 (83.505)*	55,628
Radiological Systems Maintenance	83.206 (83.508)*	331,933
National Shelter Survey	83.207 (83.509)*	676,449
State Radiological Defense Officers	83.209 (83.511)*	88,235
Civil Defense--State and Local Supporting Materials	83.211 (83.513)*	28,921
Disaster Assistance	83.300 (83.516)*	26,356,393
Emergency Management Institute-- Student Expense Program	83.400	296,604
State and Local Emergency Operating Centers	83.512	10,071
Other--U.S. Federal Emergency Management Administration	83.999	6,540

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Justice:		
State Medicaid Fraud Control Units	13.775	3,000,000 A
Law Enforcement Assistance-- Discretionary Grants	16.501 (16.531)*	1,513,692
Antitrust State Enforcement	16.700	86,570
Other--U.S. Department of Justice	16.999	12,140
State Controller:		
Comprehensive Employment and Training Programs	17.232	133,534
Other--U.S. Department of Treasury	21.999	7,206
Construction Grants for Wastewater Treatment Works	66.418	482,206
Division of Consumer Services:		
Consumers' Education	84.082	63,546
Other--U.S. Consumer Product Safety Commission	87.999	6,500
Department of Fair Employment and Housing:		
Employment Discrimination-- State and Local Anti- Discrimination Agency Contracts	30.002	1,660,781

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
State Fire Marshal:		
Other--U.S. Federal Emergency Management Administration	83.999	40,140
Department of General Services:		
Minority Business Development-- Management and Technical Assistance	11.800	30,713
State Energy Conservation	81.041	57,688
Public Works Employment Act-- Title I	98.006	1,247,633
Intergovernmental Personnel Act Advisory Council:		
Intergovernmental Personnel Grants	27.012	316,843
Veterans Home of California:		
Medicare-Supplementary Medical Insurance	1.773	2,227,172
Health Insurance for the Aged-- Supplementary Medical Insurance	13.774	2,674,574
Veterans State Domiciliary Care	64.014	1,487,153
Veterans State Nursing Home Care	64.015	2,801,864
Veterans State Hospital Care	64.016	144,597

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Economic and Business Development:		
Economic Development--Support for Planning Organizations	11.302	68,250
Economic Development--Public Works Impact Projects	11.304	472,000
Special Economic Development and Adjustment Assistance Program--Sudden and Severe or Long-Term Economic Deterioration	11.307	885,569
Department of Housing and Community Development:		
Lower-Income Housing Assistance Program	14.156	8,418,589
Community Development Block Grants/Small Cities Program	14.219	544,996
Other--U.S. Department of Housing and Urban Development	14.998	54,758
Department of Transportation:		
Other--U.S. Department of Agriculture	10.992	173
Other--U.S. Department of Agriculture	10.994	29,880
Other--U.S. Department of Defense	12.991	104,178

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Transportation:		
Other--U.S. Department of Defense	12.999	4,481
Other--U.S. Department of the Interior	15.992	69,173
Other--U.S. Department of the Interior	15.993	21,819
Other--U.S. Department of the Interior	15.997	1,491
Other--U.S. Department of the Interior	15.999	400
Other--U.S. Department of Justice	16.993	10,502
Highway Planning and Construction	20.205	481,369,912 A
Highway Beautification--Control of Outdoor Advertising and Control of Junkyards	20.214	14,400
Local Rail Service Assistance	20.308	242,865
Urban Mass Transportation Capital Improvement Grants	20.500	2,114,977 A
Mass Transportation Technology	20.504	359,013
Urban Mass Transportation Technical Studies Grant	20.505	725,283
Urban Mass Transportation Demonstration Grants	20.506	45,877
Urban Mass Transportation Capital and Operating Assistance Formula Grants	20.507	2,000,000
Other--U.S. Department of Transportation	20.994	550,121
Other--U.S. Environmental Protection Agency	66.998	79
Appropriate Energy Technology	81.051	47,500

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

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* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Office of Traffic Safety:		
State and Community Highway Safety	20.600	10,584,116
Department of California Highway Patrol:		
State and Community Highway Safety	20.600	130,239
Department of Motor Vehicles:		
State and Community Highway Safety	20.600	79,959
Other--U.S. Department of Transportation	20.999	68,084
Energy Resources Conservation and Development Commission:		
Research and Development in Energy Conservation	81.035	439,697
Research and Development--Fission, Fossil, Solar, Geothermal, Electric, and Storage Systems	81.037	28,502
State Energy Conservation	81.041	3,159,574
Supplemental State Energy Conservation	81.043	649,569

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
California Waste Management Board:		
Hazardous Waste Management Financial Assistance to States	66.451 (66.801)*	170,228
Air Resources Board:		
Air Pollution Control Program Grants	66.001	1,046,629 A
Department of Conservation:		
Geologic and Mineral Resource Surveys and Mapping	15.800	111,280
Highway Planning and Construction	20.205	6,360
Research and Development-- Fission, Fossil, Solar, Geothermal, Electric, and Storage Systems	81.037	170,301
Department of Forestry:		
Agricultural Conservation Program	10.063	31,916
Forestry Incentives Program	10.064	55,500
Forestry Research	10.652	50,000
Cooperative Forestry Assistance	10.664	1,275,495
Resource Conservation and Development	10.901	22,600

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Forestry:		
Other--U.S. Department of the Interior	15.999	910,400
Prevention and Suppression Agreement	98.015	160,696
Other--U.S. Department of Treasury	98.099	369,154
Seismic Safety Commission:		
Other--U.S. Federal Emergency Management Administration	83.999	391,916
Department of Fish and Game:		
Anadromous and Great Lakes Fisheries Conservation	11.405	324,828
Commercial Fisheries Research and Development	11.407	91,987
Coastal Zone Management Estuarine Sanctuaries	11.420	57,672
Other--U.S. Department of Commerce	11.999	588,793
Other--U.S. Department of Defense Training and Technical Assistance--Indian Tribal Governments	12.999	293,190
Small Reclamation Projects	15.143	27,297
Anadromous Fish Conservation	15.503	18,713
Fishery Research--Information	15.600	15,920
Fish Restoration	15.604	147,589
	15.605	1,513,089 A

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Fish and Game:		
Migratory Bird Banding and Data Analysis	15.606	596
Wildlife Restoration	15.611	4,592,547 A
Endangered Species Conservation	15.612	304,594
Other--U.S. Department of the Interior	15.999	1,676,517
California Coastal Commission:		
Coastal Zone Management Program Administration	11.419	876,960
Coastal Energy Impact Program-- Formula Grants	11.421	1,833,004
Department of Parks and Recreation:		
Comprehensive Planning Assistance	14.203	301,101
Disaster Assistance	14.701	400,197
Outdoor Recreation--Acquisition, Development and Planning	15.400 (15.916)*	13,784,379 A
Historic Preservation Grants-in- Aid	15.904	916,970
Department of Water Resources:		
Flood Control Projects	12.106	116,893
Small Reclamation Projects	15.503	58,544

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Water Resources:		
National Water Research and Development Program	15.950	92,761
Basic Energy Sciences, High Energy/Nuclear Physics, Fusion Energy, Health and Environmental Research, Program Analysis and Field Operations Management	81.049	7,904
Flood Insurance	83.100	109,882 A
Public Works Employment Act-- Title I	98.006	30,684
Other--U.S. Department of Treasury	98.099	101,457
State Water Resources Control Board:		
Intergovernmental Mobility of Federal, State, and Local Employees	27.011	954,356
Construction Grants for Waste- water Treatment Works	66.418	237,009
Water Pollution Control--State and Interstate Program Grants	66.419	2,585,350 A
Water Pollution Control--State and Local Manpower Program Development	66.420	7,164
Water Pollution Control--State and Areawide Water Quality Management Planning Agency	66.426	2,025,597 A
State Underground Water Source Protection--Program Grants	66.433	182,876

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
State Water Resources Control Board:		
Water Pollution Control--Lake Restoration Cooperative Agreements	66.435	183,906
Construction Management Assist- ance Grants	66.438	6,555,697 A
Water Pollution Control--Research, Development, and Demonstration Grants	66.505	104,234
State Council on Developmental Disabilities:		
Administration on Developmental Disabilities--Basic Support and Advocacy Grants	13.630	3,142,772
Emergency Medical Service Authority:		
Preventive Health and Health Services Block Grant	13.991	1,598,000 A
Office of Statewide Health Planning and Development:		
Medical Facilities Construction-- Formula Grants	13.220 (13.887)*	796,132
Health Services Research and Development Grants	13.226	3,328

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Office of Statewide Health Planning and Development:		
National Health Service Corps Scholarship Program	13.288	48,307
State Health Planning and Development Agencies	13.293	1,117,452
Health Planning--Health Systems Agencies	13.294	33,450
Department of Aging:		
Food Distribution	10.550	7,289,803
Special Programs for the Aging-- Title III, Parts A and B-- Grants for Supportive Services and Senior Centers	13.633	58,070,983 A 0
Special Programs for the Aging-- Title IV--Part C--Discretionary Projects and Programs	13.634 (13.668)*	146,000 0
Special Programs for the Aging-- Title IV-A Training	13.637 (13.668)*	224,000 A 0
Senior Community Service Employment Program	17.235	4,630,090
Department of Alcohol and Drug Programs:		
Drug Abuse Community Service Programs	13.235	5,591,758
Alcohol Formula Grants	13.257	(71,552)

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

0 - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Alcohol and Drug Programs:		
Drug Abuse Prevention Formula Grants	13.269	152,210
Drug Abuse Prevention Programs	13.275	281,164
Drug Abuse Clinical or Service Related Training Programs	13.280	6,962
Assistance Payments--Maintenance Assistance	13.808	1,033,835
Alcohol and Drug Abuse and Mental Health Services Block Grant	13.992	17,994,950
Alcohol and Drug Abuse Education Program	84.008	29,399
Governor's Advisory Committee on Child Development Programs:		
Administration for Children, Youth and Families--Child Welfare Research and Demonstration	13.608	39,800
Department of Health Services:		
Special Supplemental Food Program for Women, Infants, and Children	10.557	92,519,807 A
Food and Drug Administration-- Research	13.103	410,422
Maternal and Child Health Federal Consolidated Programs	13.110	94,190

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Health Services:		
Services for Crippled Children	13.211 (13.994)*	170,001
Health Services Research and Development Grants	13.226	82,619
Maternal and Child Health Services	13.232 (13.994)*	3,346,655
Occupational Safety and Health-Research Grants	13.262	76,336
Urban Rat Control	13.267 (13.994)*	415,000
Childhood Immunization Grants	13.268	484,700
Center for Disease Control-- Investigations and Technical Assistance	13.283	88,500
Sudden Infant Death Syndrome Information and Counseling Program	13.292	55,000
Biomedical Research Support	13.337	85,600
Cancer Cause and Prevention Research	13.393	448,296
Cancer Control	13.399	247,890
Consumer Affairs	13.678	49,274
Medical Assistance Program	13.714	2,157,759,998 A 0
Health Financing Research, Demonstrations and Experiments	13.766	335,811
State Health Care Providers Survey Certification	13.777	2,612,836 0
Supplemental Security Income	13.807	45,000
Heart and Vascular Diseases Research	13.837	1,148,843

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

0 - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Health Services:		
Biological Basic Research	13.854	43,000
Microbiology and Infectious Diseases Research	13.856	285,488 A
Research for Mothers and Children	13.865	247,400
High Blood Pressure Control Program	13.882 (13.991)*	902,200 A
Genetic Diseases Testing and Counseling Services	13.890 (13.994)*	317,100 A
Preventive Health Services-- Fluoridation Grant	13.980 (13.991)*	29,700 A
Grants for Health Education-- Risk Reduction	13.981 (13.991)*	1,068,322
Health Programs for Refugees	13.987	507,000
Cooperative Agreements for State-Based Diabetes Control Programs	13.988	19,000
Preventive Health and Health Services Block Grant	13.991	3,565,582 A
Maternal and Child Health Services Block Grant	13.994	12,161,184
Other--U.S. Department of Health and Human Services	13.999	122,718
Mathematical and Physical Sciences	47.049	55,000
Air Pollution Control--Technical Training	66.006	38,400

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Health Services:		
Air Pollution Control--National Ambient Air and Source Emission Data	66.007	129,286
Quiet Communities--State and Local Capacity Building Assistance	66.031	30,783
Hazardous Waste Management Financial Assistance to States	66.451 (66.801)*	3,650,653 0
Water Research and Demonstration Grants	66.506	2,286,200 A
Toxic Substances Research Grants	66.507	2,500
Department of Developmental Services:		
Medical Assistance Program	13.714	4,213,476
The Foster Grandparent Program	72.001	696,389
Public Works Employment Act-- Title I	98.006	9,173
Miscellaneous		210,000
Camarillo State Hospital:		
Mental Health Clinical or Service Related Training Grants	13.244	22,131

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Mental Health:		
Mental Health--Hospital Improvement Grants	13.237	208,783
Mental Health Clinical or Service Related Training Grants	13.244	332,000
Alcohol and Drug Abuse and Mental Health Services Block Grant	13.992	8,227,321
Employment Development Department:		
Food Stamps	10.551	683,872 A
Work Incentive Program	13.646	22,194,449 A
Employment Service	17.207	82,514,182 A
Job Corps	17.211	1,503,715
Unemployment Insurance	17.225	211,824,878 A
Comprehensive Employment and Training Programs	17.232	30,296,399 A
Youth Employment and Training	17.240 (17.232)*	637,753
Summer Programs for Economically Disadvantaged Youth	17.242 (17.232)*	2,056,654
Disabled Veterans Outreach Program	17.244 (17.801)*	4,574,903
U.S. Department of Labor-- Federal Unemployment Benefits and Allowances	98.010	87,340,345 A
U.S. Department of Treasury-- Reed Act	98.012	147

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Rehabilitation:		
Rehabilitation Services--Basic Support	84.126	71,633,817 A
Rehabilitation Services--Special Projects	84.128	621,823
Rehabilitation Training	84.129	206,871
Centers for Independent Living	84.132	455,555
Other--U.S. Department of Education	84.999	1,454,171
Department of Social Services:		
Food Stamps	10.551	52,899,042 A 0
Administration for Children, Youth, and Families--Child Welfare Research and Demonstration	13.608	90,000
Child Abuse and Neglect Prevention and Treatment	13.628	486,870 0
Administration on Developmental Disabilities--Basic Support and Advocacy Grants	13.630	138,919
Special Programs for the Aging--Title IV--Part C--Discretionary Projects and Programs	13.634 (13.668)*	(18,556)
Social Services for Low Income and Public Assistance Recipients	13.642 (13.667)*	242,931,513 A
Child Welfare Services--State Grants	13.645	18,114,756
Work Incentive Program	13.646	7,904,448 A

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

0 - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Social Services:		
Child Support Enforcement	13.679	87,907,926 A
Health Financing Research, Demonstrations and Experiments	13.766	198,211
Social Security--Disability Insurance	13.802	67,424,624 A 0
Supplemental Security Income	13.807	113,553 0
Assistance Payments--Maintenance Assistance	13.808	1,609,917,081 A 0
Assistance Payments--State and Local Training	13.810	69,570
Assistance Payments--Research	13.812	79,356
Refugee Assistance--Cuban Program Phasedown	13.813	18,109,821
Refugee Assistance--State Administered Programs	13.814	236,503,231 A
Low Income Home Energy Assistance Program	13.816 (13.818)*	8,022,206 A
Department of Corrections:		
Law Enforcement Education Program--Student Financial Aid	16.504	17,098 A
Corrections--Policy Formation	16.604	2,221
Other--U.S. Department of Justice	16.999	182,838
Construction Grants for Wastewater Treatment Works	66.418	546,688

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of the Youth Authority:		
Law Enforcement Assistance-- Discretionary Grants	16.501	52
National Institute for Juvenile Justice and Delinquency Prevention	16.542	6,977
Other--U.S. Department of Justice	16.999	52,202
The Foster Grandparent Program	72.001	139,057
Northern Schools:		
The Foster Grandparent Program	72.001	40,727
Department of Education:		
Food Distribution	10.550	1,309,952 A
School Breakfast Program	10.553	42,208,791 A
Equipment Assistance for School Food Service Programs	10.554	224,932
National School Lunch Program	10.555	249,901,878 A
Special Milk Program for Children	10.556	1,357,160
Child Care Food Program	10.558	33,578,165 A
Summer Food Service Program for Children	10.559	36,363
State Administrative Expenses for Child Nutrition	10.560	3,259,887
Nutrition Education and Training Program	10.564	930,116
National School Lunch/Child Nutrition	10.999	1,454,364
Vocational Education--Innovation	13.502	536,129
	(84.050, 84.051)*	

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Education:		
Other--U.S. Veterans Administration	64.999	1,059,696
Adult Education--State Administered Program	84.002	6,261,448
Bilingual Education	84.003	785,132 A
Civil Rights Technical Assistance and Training	84.004	675,976
Teacher Centers	84.006	15,411
Program for Education of Handicapped Children in State Operated or Supported Schools	84.009	1,955,629
Educationally Deprived Children-- Local Educational Agencies	84.010	208,946,395 A
Migrant Education--Basic State Formula Grant Program	84.011	61,789,050 A
Educationally Deprived Children-- State Administration	84.012	2,756,431
Educationally Deprived Children in State Administered Institutions Serving Neglected or Delinquent Children	84.013	3,342,683
Handicapped Early Childhood Assistance	84.024	52,710
Handicapped Innovative Programs-- Deaf-Blind Centers	84.025	1,160,390
Handicapped Media Services and Captioned Films	84.026	1,353
Handicapped Preschool and School Programs	84.027	87,547,307 A
Training Personnel for the Education of the Handicapped	84.029	324,599
Public Library Services	84.034	3,432,565
Interlibrary Cooperation	84.035	715,990
Strengthening State Educational Agency Management	84.043	19,525

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Education:		
Vocational Education--Basic Grants to States	84.048	50,571,277 A
Vocational Education--Consumer and Homemaking Education	84.049	3,856,452
Vocational Education--Program Improvement and Supportive Service	84.050	10,580,162 A
Vocational Education--Special Programs for the Disadvantaged	84.052	1,574,552
Indochina Refugee Children Assistance	84.068	(15,421)
National Diffusion Network	84.073	170,102
Career Education	84.074	592,223 A
Education for Gifted and Talented Children and Youth	84.080	43,889 A
Community Education	84.081	54,131
Instructional Materials and School Library Resources	84.088	20,691,594
Improvement in Local Educational Practice	84.089	9,724,303
Basic Skills Improvement	84.105	144,005
Emergency School Aid Act-- State Agency Grants	84.110	100,193
Educational Services to Cuban and Haitian Entrant Child	84.138	217
Migrant Education--Interstate and Intrastate Coordination Program	84.144	12,855
Transition Program for Refugee Children	84.146	7,631,733
Improving Schools Programs-- State Block Grants	84.151	33,922,960 A
Other--U.S. Department of Education	84.999	167,138

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
State Library:		
Public Library Services	84.034	276,073
Interlibrary Cooperation	84.035	20,849
California Advisory Council on Vocational Education and Technical Training:		
Vocational Education--State Advisory Councils	84.053	200,000
California Occupational Informational Coordinating Committee:		
Vocational Education--Program Improvement and Supportive Services	84.050	105,014
Commission on Teacher Credentialing:		
Capacity Building for Statistical Activities	13.922	32,182
California Postsecondary Education Commission:		
College Library Resources	13.406	840
University Community Service-- Grants to States	13.491	(3,787)

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
University of California:		
Other--U.S. Department of Agriculture	10.999	100,000
Hastings College of Law:		
College Work-Study Program	84.033	176,147
National Defense/Direct Student Loans	84.038	413,607
Board of Trustees - Fiscal Management:		
U.S. Department of Housing and Urban Development-- Interest Reduction Construction	98.013	1,267,074
California State University:		
Other--U.S. Department of Agriculture	10.999	1,612
Public Telecommunications Facilities	11.550	347,495
Other--U.S. Department of Defense	12.999	13,894
Alcohol, Drug Abuse, and Mental Health Administration Scientific Communications and Public Education	13.243	1,746
Occupational Safety and Health Research Grants	13.262	49,818
Professional Nurse Traineeships	13.358	158,675
Nursing Student Loans	13.364	40,277

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
California State University:		
Nursing Capitation Grants	13.386	25,278
Indian Education-Higher Education Grant Program	15.114	94,620 A
Other--U.S. Department of the Interior	15.999	1,489
Intergovernmental Mobility of Federal, State, and Local Employees	27.011	22,875
Aerospace Education Services Project	43.001	133,280
Science Education Development and Research and Resources Improvement	47.048	12,411
Management Assistance to Small Businesses	59.005	5,000
Veterans Educational Assistance	64.111	9,903
Other--U.S. Veterans Administration	64.999	11,681
College Library Resources	84.005	14,706
Supplemental Educational Opportunity Grants	84.007	6,886,675
College Work-Study Program	84.033	8,965,644
National Defense/Direct Student Loan Cancellations	84.037	1,279,860
National Defense/Direct Student Loans	84.038	755,795
Pell Grant Program	84.063	34,077,554
Higher Education--Veterans Cost of Instruction Program	84.064	63,006
Indian Education--Fellowships for Indian Students	84.087	18,225
Regional Education Programs for Deaf and Other Handicapped Persons	84.078	710,780

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
California Maritime Academy:		
State Marine Schools	11.506	451,836
College Library Resources	84.005	840
Board of Governors of the California Community Colleges:		
Fund for the Improvement of Postsecondary Education	84.116	23,184
Student Aid Commission:		
Higher Education Act Insured Loans	13.460	9,348,899
Grants to States for State Student Incentives	13.548	11,508,111
Office of Criminal Justice Planning:		
Law Enforcement Assistance-- Improving and Strengthening Law Enforcement and Criminal Justice	16.502 (16.530, 16.532)*	3,858,233
Juvenile Justice and Delinquency Prevention--Allocation to States	16.540	5,041,767

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
California Arts Council:		
Promotion of the Arts--Dance	45.002	50,000
Promotion of the Arts--Artists- in-Education	45.003	238,096
Promotion of the Arts--Public Partnership	45.007	788,104
California Public Broadcasting Commission:		
Public Telecommunications Facilities	11.550	50,000
Department of Industrial Relations:		
Occupational Safety and Health	17.500	15,698,465
Veterans Educational Assistance	64.111	280,284
California Exposition and State Fair:		
Public Works Employment Act-- Title I	98.006	174,165
Department of Food and Agriculture:		
Plant and Animal Disease and Pest Control	10.025	8,113,435
Market News	10.153	126,099
Marketing Agreements and Orders	10.155	2,620
Federal-State Marketing Improvement Program	10.156	73,249

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Department of Food and Agriculture:		
Agricultural Statistical Reports	10.252	300,393
Egg Products Inspection	10.476	127,771
Meat and Poultry Inspection	10.477	484,269
Agricultural Research--Basic and Applied Research	10.875	1,536
Grants for Agricultural Research, Special Research Grants	10.876	114,955
Economic Development--Technical Assistance	11.303	87,583
Food and Drug Administration-- Research	13.103	10,503
Federal Reclamation Projects	15.504	5,000
Intergovernmental Mobility of Federal, State, and Local Employees	27.011	15,761
Pesticides Enforcement Program Grants	66.700	476,098
Other--U.S. Environmental Protection Agency	66.999	35,867

Commission of the Californias:

Economic Development--State and Local Economic Development Planning	11.305	75,000
Miscellaneous		50,000

Military Department:

Other--U.S. Department of Defense	12.999	104,023
U.S. Department of Defense-- Operating Reserve Guard Training	98.008	8,512,039

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

<u>State Agency/Program Title</u>	<u>Federal Catalog Number</u>	<u>Grant Monies Received</u>
Miscellaneous:		
Shared Revenue Program	98.001	5,364,683
Shared Revenue--Flood Control	98.002	319,398
Shared Revenue--Forest Resource	98.003	18,930,649
Shared Revenue--Grazing Land	98.004	207,146
Shared Revenue--Potash/Sodium Lease	98.005	36,572,763 A
Miscellaneous Federal Funds	98.999	569,302
Miscellaneous Uncleared Collections	99.999	<u>125,894</u>
Total		<u><u>\$7,037,307,666</u></u>

A - Grants reviewed by the Office of the Auditor General for the fiscal year 1982-83, Circular A-102P compliance audit.

O - Grants reviewed by the Office of the Auditor General in conjunction with various reports issued from July 1, 1982, through December 31, 1983. See Appendix B for a description of these reports.

* The State of California recorded receipts under federal catalog numbers that were subsequently changed. The numbers in parentheses represent the most recent federal catalog numbers.

DEPARTMENT OF FINANCE

DIRECTOR'S OFFICE
SACRAMENTO

March 19, 1984

Mr. Thomas W. Hayes
Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Report F-374--The State of California Could Improve Its Control of Financial Operations

Dear Mr. Hayes:

I appreciate the opportunity to respond to a draft copy of subject report. I readily agree that improvements can be made in the control of financial operations in California, and I believe we have taken a number of positive actions toward this goal. These include the development of and subsequent implementation in a great number of state departments of the new standardized accounting system called "CALSTARS." In addition, we have in place expanded internal audits carried out by the Department of Finance staff or by internal audit staffs of state departments utilizing Finance audit programs.

The installation of CALSTARS has been accompanied by a number of problems, some of which have been cited in your report. We do not find this to be unusual, taking into account the complexity of the system and the diversity of programs found in the various state departments. The CALSTARS program represents an advanced accounting system which utilizes the most modern electronic data processing techniques. When it has been completely installed and all state staff become familiar with its procedures, many of the problems in state accounting systems and procedures will have been solved. Progress of this magnitude cannot be attained without the growing pains we have been experiencing.

In the area of internal controls, we are also making progress. During calendar year 1983, the Department of Finance completed 54 reviews and evaluations of systems of internal control and fiscal compliance procedures at various state agencies. Reports resulting from these reviews were issued which included: Opinions as prescribed by the Statement on Auditing Standards (SAS), No. 30, Paragraph 3 to 46; recommendations for improvements; and agency responses for all 54 reviews. Many of these findings were confirmed and reported in your publication. However, we have gone one step further and are working with the agencies' management to make the necessary changes to improve the systems of control. We have also issued instructions in the State Administrative Manual regarding internal control reviews by agency internal auditors. A number of these reviews have been completed and are now undergoing our quality control review

to insure that they were conducted in accordance with the audit guide we developed and provided agency internal auditors and the Standards for Professional Practice of Internal Auditing published by the Institute of Internal Auditors, Inc., as prescribed by Section 1236 of the Government Code (AB 1229/82).

The subject report is divided into three specific areas. Similar reports were issued during 1983, however, they were issued in two separate publications which I feel was a more satisfactory approach. The following are my comments regarding the areas.

Summary of Audit Results

This section is similar to your report F-283 issued in August 1983 and entitled "Weaknesses in Internal Controls of State Agencies." The specific references in this summary were taken from the detailed reports included in the other two sections. We do not take issue with the specifics since we acknowledge that there are opportunities for improvements. However, since this report is to be used as a major section of the State of California report on the state as a whole under the provisions of OMB Circular A-102, Attachment P, we are of the opinion that it does not reflect the professional reporting standards which we feel should be utilized.

Specifically, reports should be in accordance with the Standards for Audit of Governmental Organizations, Programs, Activities and Functions, published by the Comptroller General of the United States. The three areas within those standards we believe have been omitted from this section of the report are "Objectivity," and "Completeness," and "Constructiveness of Tone." We feel that the State of California would be better served if the findings which we are working to correct were presented in a positive perspective with emphasis on needed improvements. ① *

Conclusions and Summaries

This final section within the summary of the report illustrates my point.

- a. The first recommendation is that the Department of Finance monitor state agencies to insure weaknesses are corrected. No reference is made in the report to the fact that the Department of Finance is currently engaged in this activity and, in fact, is reviewing systems of internal control in all state agencies with the assistance of departmental internal auditors on a two-year cycle. Further, it makes no reference to our efforts to implement the provisions of the Financial Integrity and State Manager's Accountability Act of 1983 (Chapter 630/82) through Sections 20010, et. seq., of the State Administrative Manual.

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* The Auditor General's comments on specific points contained in the department's response begin on page 207

- b. The second recommendation pertains to the Department of Finance modifying the State Administrative Manual so that state agency reports would facilitate preparation of the state's financial statements by the State Controller according to GAAP. Again, while we are working toward GAAP compliance, the report fails to cite the fact that only the Legislature can direct that the state's accounts be in accordance with GAAP. By law, we must present them on the "Legal Basis" which differs from the GAAP principles. The Department of Finance does have a committee working on this GAAP project and the necessary changes will be published when GAAP is adopted by the Legislature. (2)

Report on the Study and Evaluation of Internal Controls

We accept this report and the accompanying schedules as being in accordance with professional standards and helpful in our collective efforts to improve the financial operation of our state. The opinion which precedes this section indicates weaknesses, but fairly states that the major material weakness is in Accounting for Fixed Assets. We accept this statement and assure you that we are working to overcome this material weakness within the constraints of the limited personnel which we can dedicate to this effort.

Report on Compliance with Federal Grant Requirements

We accept this positive/negative assurance statement regarding the State of California's compliance with the terms and conditions of federal grant awards and applicable federal regulations. It is in accordance with professional standards. Although not referenced in the report, the Department of Finance complemented this effort by the staff of the Auditor General by issuing 46 reports covering the review of federal financial reports in accordance with the provisions of Paragraph 6(c) and 10(d) of Federal OMB Circular A-102, Attachment P.

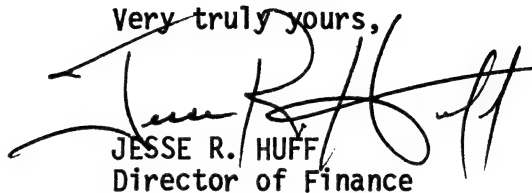
In conclusion, I appreciate the effort put forth by the Office of the Auditor General in the examination of the financial operations of the State of California. This effort is a major contributor to our efforts to meet the provisions of OMB Circular A-102, Attachment P, which covers the state's audit requirements pertaining to the receipt of federal funds. However, I also feel that recognition should be given to the other parties who are cooperatively

Thomas W. Hayes

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engaged in meeting the objectives of proper administration of our state government. The presentation of findings in an objective fashion, giving proper emphasis on matters needing attention, will be the best method to insure that the needed improvements are implemented as we all desire.

Very truly yours,



JESSE R. HUFF
Director of Finance

cc: Karl Dolk, Assistant Auditor General
Office of the Auditor General

FP1692D

**AUDITOR GENERAL'S COMMENTS ON
THE DEPARTMENT OF FINANCE'S RESPONSE**

- ① In his response, the Director of Finance is concerned that the Audit Results section lacks "objectivity," "completeness," and "constructiveness of tone," and therefore, does not meet professional audit standards. Apparently, he believes that this section of the report is too harsh. This is not correct.

We have carefully worded our report to present clearly those problems that we identified and that need attention. We also provide constructive comments for correcting these problems as well as the problems we identified in previous years that remain uncorrected.

The following analysis specifically addresses the director's comments. First, he questions whether our report complies with the report presentation provisions of the Comptroller General's Standards for Audit of Governmental Organizations, Programs, Activities and Sanctions. These reporting standards relate to audits of economy, efficiency, and program results; they do not apply to financial and compliance audits, such as this audit. Nevertheless, we have met all of these reporting standards.

The standard of objectivity states generally that the report should describe the size and nature of the agencies and programs audited, explain sample selection methods and sample sizes, and be fair and not misleading. We consistently meet this standard throughout our report. (See pages 1, 2, 16, and 31 for examples.) The completeness standard states that the report should provide sufficient information to facilitate understanding. Our 201-page report, with its three sections and appendices, provides complete information. It was not intended that the Audit Results section be used without considering the entire report, as the director apparently has done. The standard for constructiveness of tone states that the report should emphasize needed improvements and not dwell on the negative. As stated above, we believe the findings are presented in clear, forthright terms that emphasize needed improvements. In fact, the tone of our Audit Results section is the same as the tone of the detailed discussion of weaknesses in the Report on the Study and Evaluation of Internal Control section, which the director has referred to as "being in accordance with professional standards and helpful in our collective efforts to improve the financial operation of our state."

- ② The director states that we have not made reference to the Department of Finance's review of state agencies. This is incorrect. We have referred to these reviews on pages 33 and 59 of this report. The director also states that our report "fails to cite the fact that only the Legislature can direct that the State's accounts be in accordance with GAAP." Our recommendation is feasible because we have not suggested that the State cease preparing financial statements on the "legal" basis, only that the records be kept in a way to facilitate the preparation of GAAP-based financial statements. What we have recommended is totally within the authority of the Department of Finance and does not necessitate legislative direction.

APPENDIX A

**REPORTS ISSUED BY THE
OFFICE OF THE AUDITOR GENERAL
JULY 1, 1982 TO JUNE 30, 1983**

<u>DATE</u>	<u>TITLE</u>	<u>REPORT #</u>
AUG 12	OPERATIONS OF THE LONG BEACH COMMUNITY SERVICES DEVELOPMENT CORPORATION	P-222
AUG 13	REVIEW OF THE BOARD OF MEDICAL QUALITY ASSURANCE	P-035
AUG 20	STATE AND FEDERAL PROCEDURES CAN BE IMPROVED TO ENSURE THAT SSI/SSP RECIPIENTS RECEIVE THEIR SOCIAL SECURITY BENEFITS	P-070
AUG 23	THE DEPARTMENT OF HEALTH SERVICES CAN IMPROVE THE ENFORCEMENT OF HEALTH CARE STANDARDS IN LONG-TERM CARE FACILITIES	P-202
AUG 24	ATHLETIC CONDITIONING COURSES PROVIDED BY BUTTE COLLEGE FOR CSU CHICO ATHLETES	P-234
AUG 25	THE CALIFORNIA PUBLIC UTILITIES COMMISSION NEEDS TO IMPROVE ITS REGULATORY CONTROL OF UTILITIES' CONSTRUCTION PROJECTS	P-091
SEP 1	IMPROVEMENTS NEEDED IN ADMINISTERING STATE-FUNDED CHILD CARE PROGRAMS	P-098
SEP 2	THE DEPARTMENT OF SOCIAL SERVICES COULD MORE EFFECTIVELY USE THE DATA FROM THE AFDC QUALITY CONTROL REVIEWS	P-107
OCT 12	STATE HOSPITAL POLICIES ON FIELD TRIPS BY MENTALLY ILL PATIENTS COMMITTED BY THE COURTS AND THE DEPARTMENT OF CORRECTIONS	P-116
OCT 12	STATE COSTS FOR MEDI-CAL FISCAL INTERMEDIARY SERVICES SUPPLIED BY COMPUTER SCIENCES CORPORATION, 1978-1983	P-228.4
OCT 15	STATUS REPORT ON THE SELECTION OF THE NEXT MEDI-CAL FISCAL INTERMEDIARY	P-228.2
NOV 9	MANAGEMENT AND ADMINISTRATION OF THE VETERANS HOME POST FUND	P-260
NOV 22	THE DEPARTMENT OF MENTAL HEALTH'S METHOD OF ALLOCATING STATE HOSPITAL DAYS OF SERVICE TO COUNTIES DURING FISCAL YEARS 1979-80 AND 1980-81	P-248

<u>DATE</u>	<u>TITLE</u>	<u>REPORT #</u>
NOV 22	REVIEW OF CALIFORNIA'S SCHOOL BUILDING LEASE-PURCHASE PROGRAM	P-236
NOV 24	REVIEW OF THE STATE BOARD OF LANDSCAPE ARCHITECTS	P-246
DEC 3	THE DEPARTMENT OF AGING HAS IMPROVED ITS ADMINISTRATION OF PROGRAMS FOR THE ELDERLY	P-231
DEC 3	REVIEW OF THE DEPARTMENT OF PERSONNEL ADMINISTRATION	P-247
JAN 10	UNIVERSITY OF CALIFORNIA PROPERTY MANAGEMENT	P-089
JAN 10	REVIEW OF THE REQUEST FOR PROPOSAL PROCESS USED BY THE OFFICE OF ECONOMIC OPPORTUNITY TO DISTRIBUTE FEDERAL COMMUNITY SERVICES BLOCK GRANT FUNDS	P-272
JAN 24	REVIEW OF LOS ANGELES COUNTY'S WELFARE CASE MANAGEMENT INFORMATION SYSTEM/INTEGRATED BENEFIT PAYMENT SYSTEM	P-249.1
JAN 31	REVIEW OF STANDARDIZED FORMS FOR PRE- AND POST-EVALUATION OF CONSULTING SERVICES CONTRACTS	P-273
JAN 31	ADEQUACY OF THE FOSTER CARE OPERATIONS PROVIDED BY THE DEPARTMENT OF YOUTH AUTHORITY FOR YOUTHS UNDER 18	P-096
FEB 7	STATUS OF THE MEDI-CAL PROCUREMENT PROJECT AND REVIEW OF ITS DRAFT REQUEST FOR PROPOSAL	P-228.3
FEB 28	ADMINISTRATION OF THE PETITION PROCESS FOR MOBILE HOME FEES	P-251
MAR 15	THE STATE DEPARTMENT OF SOCIAL SERVICES CAN REDUCE AFDC COST BY ENSURING THAT COUNTY CHILD SUPPORT PROGRAMS OPERATE MORE EFFECTIVELY	P-230
MAR 16	AGRICULTURAL LABOR RELATIONS BOARD: EXPENDITURE OF FUNDS IN THE GROWERS EXCHANGE CASE AND RELATED CASES	P-253
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JUN 10	THE EMPLOYMENT DEVELOPMENT DEPARTMENT COULD IMPROVE THE PERFORMANCE OF ITS JOB SERVICE AND UNEMPLOYMENT INSURANCE PROGRAMS	P-263
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SCHEDULE OF AUDIT REPORTS
INVOLVING FEDERAL GRANTS
JULY 1, 1982 TO DECEMBER 31, 1983

From July 1, 1982, to December 31, 1983, the Office of the Auditor General issued a number of reports on audits involving federal grants. The following schedule lists the reports issued and presents a summary of the report findings. The agencies' responses to these report findings are included in each of the separate audit reports.

Agency Receiving Federal Funds	Federal Grant	Report Title and Description
Department of Aging	Special Programs for the Aging - Title III - Parts A and B	Review of Area Agency on Aging Expenditures for Services for the Elderly for Fiscal Year 1982-83 (P-355, 11-23-83) (1) Area agencies on aging are meeting the requirements for use of Title III federal funds.
	Special Programs for the Aging - Title III - Parts A and B, Title IV Part C, and Title IV A	The Department of Aging Has Improved Its Administration of Programs for the Elderly (P-231, 12-03-82) (1) The Department of Aging has made significant improvements in its procedures to identify and redirect unused federal funds. (2) The department has also improved its procedures to assist local agencies and to control the agencies' operations effectively. (3) For fiscal year 1981-82, the department did not precisely follow its established formula for allocating funds to local agencies under the Older Americans Act of 1965. (4) The Department has established a policy to give hiring preference to persons 60 years of age or older.
Economic and Social Opportunities, Inc. (a non-profit corporation)	Various programs administered by the U.S. Department of Agriculture, the U.S. Department of Health and Human Services, and the U.S. Department of Energy	Accounting Records of Economic and Social Opportunities, Inc. (F-266, 04-11-83) (1) ESO has not maintained adequate, auditable accounting records and therefore has not complied with federal and state accounting, reporting, and auditing requirements.
Department of Health Services	Hazardous Waste Management Financial Assistance to States	The State's Hazardous Waste Management Program: Some Improvement, but More Needs To Be Done (P-343, 11-30-83) (1) The department has been slow in improving its hazardous waste management program. (2) The department has not spent all available Superfund program funds.
	Medical Assistance Program	Status of the Department of Health Services' Implementation of the Medi-Cal Co-Payment Demonstration Project (P-086, 07-20-83) (1) Because of the wide range of changes in the Medi-Cal program, the Auditor General does not believe that the department will be able to demonstrate conclusively the effectiveness or ineffectiveness of the co-payment project. Review of the Department of Health Services' Program To Recover Medi-Cal Payments Made for Work-Related Injuries (P-317, 05-05-83) (1) Beneficiary history data needed to recover Medi-Cal payments owed the State are not available in a usable form to the State. State Costs for Medi-Cal Fiscal Intermediary Services Supplied by Computer Sciences Corporation, 1978-1983 (P-228.4, 10-12-82) (1) The State did not receive approximately \$3.4 million in federal financial participation because there were delays in Medicaid Management Information System certification.

Agency Receiving Federal Funds	Federal Grant	Report Title and Description
Department of Health Services (continued)	State Health Care Providers Survey Certification	<p>The Department of Health Services Can Improve the Enforcement of Health Care Standards in Long-term Care Facilities (P-202, 08-23-82)</p> <ol style="list-style-type: none"> (1) The department is not satisfactorily enforcing state and federal health standards. (2) The department needs to investigate more promptly complaints made against long-term care facilities. (3) The department needs to improve its practices and procedures to discourage facilities from repeating violations and allowing substandard conditions to exist. (4) The department needs to improve its management information system for licensing and certification activities.
Long Beach Community Services Development Corporation, Inc. (a non-profit corporation)	Low Income Home Energy Assistance Program	<p>Operation and Management of the Long Beach Community Services Development Corporation (P-222, 08-12-82)</p> <ol style="list-style-type: none"> (1) The corporation is appropriately using its resources to serve the low-income residents of Long Beach. (2) There is a disparity between program priorities identified by the community and those contained in the corporation's 1981 work program, and substandard program budgeting and delayed federal funding in 1981 resulted in an excessive administrative cost. (3) In its first year of providing direct services, the corporation has experienced a high employee turnover rate. (4) The corporation and its delegate agencies did meet, and in most cases exceeded, their 1981 service goals except for two programs that could not document their actual accomplishments.
Office of Economic Opportunity	Low Income Home Energy Assistance Program	<p>The Office of Economic Opportunity Could Improve Its Administration of the Low Income Home Energy Assistance Block Grant (P-232, 08-30-83)</p> <ol style="list-style-type: none"> (1) The OEO has not maintained adequate control over eligibility and has not expeditiously and equitably distributed funds to three of the programs for which the OEO is responsible. (2) The OEO does not always reimburse community agencies promptly or allocate sufficient funds to all community agencies to cover their administrative costs.
	Community Services Block Grant	<p>Review of the Request for Proposal Process Used by the Office of Economic Opportunity To Distribute Federal Community Services Block Grant Funds (P-272, 01-10-83)</p> <ol style="list-style-type: none"> (1) Inadequate management control has limited the OEO's process for distributing funds under the Community Services Block Grant program. The OEO did not advertise the availability of funds as required, and the RFPs contained errors that were not corrected until late in the proposal process. Therefore, eligible agencies may have been denied an opportunity to bid for the funds, and the amount of response time available was limited.

Agency Receiving Federal Funds	Federal Grant	Report Title and Description
Department of Social Services	(1) Assistance Payments - Maintenance Assistance	Welfare Fraud Cases Awaiting Investigation: Number of Cases, Causes of the Backlog, and Amount of Potential Recoverable Funds (P-330, 05-23-83)
	(2) Food Stamps	(1) Aid to Families with Dependent Children (AFDC) cases pending fraud investigation and prosecution increased throughout the State between January 1981 and December 1982. The number of completed AFDC fraud investigations and prosecutions declined. (2) The Auditor General was unable to analyze trends in the investigation and prosecution of Food Stamp fraud cases during this period because of a change in reporting requirements.
	Assistance Payments - Maintenance Assistance	The Department of Social Services Could More Effectively Use the Data from the AFDC Quality Control Reviews (P-107, 09-02-82) (1) The department has not provided the counties sufficient assistance in reducing the level of Aid to Families with Dependent Children (AFDC) errors. (2) The department has not developed a satisfactory system for imposing fiscal sanctions on counties whose AFDC error rates exceed the set standard.
	Child Abuse and Neglect Prevention and Treatment	Compliance with the Competitive Process for Contracting with Child Abuse and Neglect Prevention Agencies (P-265, 03-14-83) (1) Training and technical assistance contracts have not been competitively bid according to state and department guidelines, and the department has selected potential contractors without sufficient justification. (2) The department has not always determined the effectiveness of its pilot and demonstration projects aimed at preventing child abuse and neglect.
Department of Social Services	(1) Supplemental Security Income	State and Federal Procedures Can Be Improved To Ensure That SSI/SSP Recipients Receive Their Social Security Benefits (P-070, 08-20-82)
Department of Developmental Services	(2) Social Security - Disability Insurance	(1) Lack of information in recipients' records and inadequate procedures for determining eligibility may have precluded the State from realizing savings by identifying those SSI/SSP recipients who are eligible for OASDI.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Director of Finance
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps